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# GENERAL ACCOUNTING OFFICE RESPONSE TO INADEQUATE MANAGEMENT CONTROLS

## HEARING

BEFORE THE

## COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

NOVEMBER 29, 1989

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# GENERAL ACCOUNTING OFFICE RESPONSE TO INADEQUATE MANAGEMENT CONTROLS

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WEDNESDAY, NOVEMBER 29, 1989

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Committee met, pursuant to notice, at 9:36 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senator Glenn.

## OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The Committee will be in order.

Mr. Bowsher, we appreciate your willingness to join us this morning for our hearing on the subject of the General Accounting Office's response to inadequate management controls. I know from past experience, when we start talking in general terms about financial management, to many people around Washington that is about as exciting as watching mud dry, and gets about as much attention.

But if we are ever going to get control of the budget of this country and get things back in balance, it is going to come, at least in part, because we did put good financial management controls in, controls that almost any major business has to have. And this being one of the biggest businesses in the world, we just have to do it.

You will recall that you were our only witness last January 18 for this Committee's very first hearing of the 101st Congress. You testified on critical issues and problems facing the new administration and Congress, and you summarized the GAO's 26 transition studies which you had done, which were presented to the new administration and to the Congress, and they were very good.

Your message at that time was not optimistic. The problems of Government were major, they were growing, and would not be easily dealt with. The expanding Federal deficit was the number one management problem, and it was leading to, as you termed it, a disinvestment in America.

Your presentation provided important themes and important warning signals for this Committee's work and for this Congress, and I felt it was important for you to be with us again at the end of this session so that perhaps you could give us an interim report card on where the Government stands.

This hearing also serves as a follow-up to hearings we held over the last few months with seven Inspectors General and the Director of the Office of Management and Budget. This Committee is committed to a more vigorous oversight of Government operations. More attention will be paid to early-warning signals generated by programs out of control.

Our hearings have focused upon what systems Government has to identify the early-warning signals and what the signals are, and we will be holding more hearings on inspector general reports. Director Darman has instituted internal controls and a management-by-objectives program which utilize IG reports and head-of-agency reports required by the Federal Managers Financial Integrity Act to develop high-risk lists for each agency; in other words, priority areas are defined. He indicates that they will get the President's attention, and we will be holding more hearings on the Administration's high-risk list and what is being done.

Our purpose today will be to hear from the Comptroller General on what GAO is doing to identify the warning signals so that early action can be taken. He will discuss GAO's report, to be released today—I think copies of it are available on the press table back there—on agency implementation of the Federal Managers Financial Integrity Act requirements.

Is the Act an effective tool in providing early-warning signals? Is it encouraging better management and corrective action? For example, NASA and HUD each provide contrasting and vivid examples of very serious problems with implementing the Act.

Following passage of the Financial Integrity Act in 1982, NASA gave a squeaky-clean report to the President and the Congress in fiscal years 1983, 1984, and 1985. Then in 1986, following the *Challenger* explosion, we all learned that NASA had very serious management problems which had not been identified in the Financial Integrity Act process.

HUD, on the other hand, provides the opposite illustration. Here Secretary Pierce wrote the President in 1983, 1984, 1985, and 1986 to say that he could not provide reasonable assurance that his internal control and accounting systems were in order.

Furthermore, he identified such now familiar problems as fraudulent escrow agents and the co-insurance program as areas of "material weaknesses." Why didn't Sam Pierce blow the whistle louder? Why didn't he take action to clean up the mess that he had identified?

These examples and many other serious problems brought to this Committee's attention by the Inspectors General lead me to fear that, number one, the Financial Integrity Act may not be working as Congress intended. And, two, are there more HUDs out there?

The GAO report released today indicates the attrocious condition of the Federal Government's management controls. These are the same controls that are there to protect us against fraud, waste, and mismanagement. Failure of these systems costs the taxpayers billions of dollars and they dramatically undermine the public's confidence in Government. The year 1989 has left us with this nagging question: How many more HUDs are out there? GOA is the Congress' premier watchdog over Government programs. I anticipate you, Mr. Bowsher, will give us your views on this question.

The release of the GAO report on the Financial Integrity Act is also timely. The Act requires department heads to report to the President and the Congress once a year whether they have reasonable assurance that their internal controls and accounting systems are in order. Those reports are due to the President and Congress in just 32 days, at the end of this year.

Lastly, I want to announce that Senator Roth and I will be once again introducing legislation to create a chief financial officer, a CFO, for the Federal Government at the very beginning of the next session. Mr. Bowsher has been the chief proponent of the need for this legislation. I hope he will speak to some of the questions involved today.

Mr. Bowsher, I look forward to your testimony about GAO's response to inadequate management controls. I am particularly eager to learn why, in spite of all the tools available to prevent fraud and waste and abuse, Federal agencies continue to face so many major scandals.

We look forward to your testimony this morning and appreciate your willingness to testify once again with us. We have with Mr. Bowsher this morning, Mr. Jeffrey Steinhoff, who is Director of Financial Management Systems Issues of GAO, and Mr. Donald Wurtz, Special Assistant, Accounting and Financial Management Division of GAO.

Mr. Bowsher, lead off with your statement, if you would. Thank you.

## TESTIMONY OF HON. CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JEFFREY C. STEINHOFF, DIRECTOR, FINANCIAL MANAGEMENT SYSTEMS ISSUES, AND DONALD R. WURTZ, SPECIAL ASSISTANT, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

Mr. BOWSHER. Thank you very much, Mr. Chairman. If you would be good enough to do it, we would like to insert the statement for the record,[1] and I would just summarize it here.

Chairman GLENN. Good, fine. The entire statement will be included in the record.

Mr. BOWSHER. Thank you. Mr. Chairman, I think you have summarized the transition reports GAO issued last year very well, and that is what we are saying is that the Federal budget deficit is very large, larger than the official figures that are presented. And we also pointed out to the new Bush Administration and to the Congress that they were inheriting some major financial problems and control problems in Government operations.

We highlighted the S&L crisis, we highlighted the nuclear weapons plants, and at the time we also said to everyone that we had an audit at HUD that was in process, and that this was a department where we had not been able to do an audit of FHA funds for a number of years, dating back to the late 1970s, because the systems were in such poor shape.

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[1] See p. 33.

We did do a management study in the mid-1980s and we were successful in talking the leadership of HUD into improving the systems. In 1987 we went back in and, with the help of Price Waterhouse and Company, were able to do a balance sheet audit, which is always the start of an audit process after you have been unable to do audits.

When we released the 1988 audit this past fall, we had to report that an $850 million problem was really a $4.2 billion problem, a deficit, that turned the fund's equity balances into a negative position.

I think you have raised a very signficant question, and that is are there more HUDs. Unfortunately, I believe there are. To what extent, we are not quite sure, but we are trying to pull together a series of GAO reviews that will look at what we think are some of the more vulnerable areas.

We also believe that the lists that OMB and the IGs have prepared are going in the right direction, and we hope that all of this work will try to give us some early warning as to what some of the problems are.

The report we are releasing today is our fourth report on the Financial Integrity Act. We believe that the legislation has been successful in getting on the record what some of the problems are, but it has not been successful in highlighting, for the decisionmakers, just where the major problems are. I think that it an area that has to be improved, and I think we have to also begin to look at more oversight by both the leadership of the Executive Branch and the Congress.

I believe that the agencies should issue an annual report. I think they should issue the annual report to the President and to the Congress. Within the annual report, I believe each major agency should have audited financial statements, and I think they should highlight or summarize their major weaknesses from their internal control reviews conducted under the Financial Integrity Act.

I think after that has been issued, it is important that the Congressional committees who have oversight hold hearings on an annual basis to find out the status of the internal control weaknesses, and equally important, what progress or lack of progress has been made in correcting those weaknesses.

As you point out, Mr. Chairman, HUD did report these weaknesses. They also indicated that there was corrective action being taken. But as so often happens, I think, in large Government agencies, it becomes somewhat of a paperwork exercise and the corrective actions really didn't get taken.

And so I think you have to have follow-up by the IG and ourselves and other organizations looking to see if the corrective action was taken and if the weakness was really resolved.

I think also, Mr. Chairman, as you point out, that financial management is a very important area. One more time, when we tally the major weaknesses like on page 19 of our report, we see that the financial management and accounting systems are listed by 17 of the 18 departments as being weak.

The only exception is NASA, and it is interesting that when NASA's high risk list was approved by OMB, it included financial systems weaknesses. I might point out that we are planning to make a special review at NASA to determine what the situation is.

A general statement is that we have every major agency in the Federal Government acknowledging that they have weak financial management systems, and when you have a trillion-dollar operation with all the major components having weak financial management systems, you have vulnerabilities that are bound to end up with scandals and fraud and mismanagement. That is the situation I think we are in, and it is a situation that we have got to work ourselves out of.

I think that legislation is needed to create a chief financial officer structure, that includes a top financial person in every major agency who is responsible for the annual statement that is sent over to Treasury.

That person has also got to be responsible for a multi-year, and we suggest a 5-year, plan to improve the financial systems. We have got to get that structure in place if we are ever going to really make progress on improving the financial management of the Federal Government.

I think that the Treasury, OMB, and GAO should be able to put together a plan for the Congress to consider, one that, should be given high priority in the coming months.

I do not believe that the CFO operation that was set at OMB 1½ or 2 years ago has been all that successful. I think some progress has been made, but at the time, if you remember, Mr. Chairman, we worried that it did not have the clout, it did not have the resources. I think that our concerns were shown to be correct and we had every right to be worried about those kinds of problems at that time.

I think legislation is needed, and that it is going to take vigorous oversight by the Congress, by the leaders of the Executive Branch, including the agency heads, the Cabinet officers, and review by GAO and the IGs, to make sure that we get these control problems under control in the future.

We have a lot of vulnerabilities that are out there that could turn into new HUDs. This is a very scary situation for the Federal Government and for the American taxpayer.

Mr. Chairman, that concludes my summary of my opening statement and we would be very pleased to answer any questions.

Chairman GLENN. Thank you very much, Mr. Bowsher. Following up on your last statement there—and I noted your complete statment will be included in the record—on the second page you end the middle paragraph by saying, "We anticipate additional tens of billions of dollars in future losses in other programs." Can you better define that as to the amount and what those programs are, as you see them right now?

Mr. BOWSHER. Well, we have looked at, of course—in the regular programs in the Federal Government, the nuclear weapon plant clean-up is just going to be huge. That is $100 to $150 billion. You have got the environmental waste clean-ups at DOD; that is going to run tens of billions of dollars.

We have got the computer and telecommunications systems at Defense, the FAA, and the IRS.

Chairman Glenn. We were going to get to those in the questioning a little bit later. I think that paragraph referred, in particular, to the Federal credit assistance and insurance programs.

Mr. Bowsher. All right.

Chairman Glenn. That was what I was asking. I think we will get on to some of the others a little later.

Mr. Bowsher. Yes. On that, we can run down this list, then, and that is the Ex-Im Bank, which we have audited and have not been able to give a clean opinion for several years now. That looks like about a $6 billion problem. The CCC is about $12 billion; Farmers Home is $26 billion; student loans are $5 billion. Foreign military sales might be as high as $10 to $20 billion. In total, these and other problems build up to somewhere between $80 and $100 billion.

Now, what is not included in that is our exposure in the GSEs. This is the agency debt that is off balance sheet, you might say, that has been built up. This has been reviewed by Congress with a lot more interest after the S&L crisis, and they have asked the GAO to do a special study and we will be reporting on that later in 1990.

Chairman Glenn. What is a GSE? Would you define that? What is GSE?

Mr. Steinhoff. Government-sponsored enterprise.

Mr. Bowsher. Government-sponsored enterprises, and the interesting thing about these, Mr. Chairman, is that we had a number of them for many years mostly in the housing area for secondary mortgages. We have created five in more in recent years since Gramm-Rudman came in.

And to a great extent, I think one of the motivations has been to take these issues off budget. We just did that again, of course, in the S&L bail-out, following the same pattern that we did with the farm credit bail-out of a couple of years ago.

So, again, we are minimizing the size of our Federal deficit by creating some of these off-budget items, but I think the Congress, as they watched the unfolding of S&L crisis, fully realized that these are potential liabilities, potential exposure to the American taxpayer. We are doing a special study on that.

Another area in the credit area that is very important and that we highlighted the other day for another hearing is guarantee programs. We have always had guarantee programs in the Federal Government, but these have been escalating in large amounts in recent years.

Some of the direct loan programs have been moved over to be guarantee programs because, again, of the budget rules. You don't have to count the dollars in the current year budget. But later on, if some of the guarantees have to be made good, such as the maritime program a few years ago in which we had several billion dollars of losses, then that year gets hit with the loss.

And so we see a trend here of going off budget, but not for a moment really reducing the risk to the American taxpayer, and sometimes having to pay higher financing costs to go off budget. And I think it is a very serious trend that the Congress has to be concerned about.

I always use the illustration on the S&L crisis that we basically did what New York City was doing back in the mid-1970s. In New

York City, they had a requirement to balance the budget each year. They did it by moving operating expenses over to the capital budget and then they sold bonds to finance that capital budget.

Well, when we moved that S&L crisis partially off budget and then sold special bonds, we are doing exactly the same thing. And, again, it helps to meet the Gramm-Rudman targets, but it doesn't lower the cost of Government; it doesn't lower the exposure that the American taxpayer has.

Chairman GLENN. You discussed last year when you were here at the beginning of this session of Congress about disinvestment in people and management systems that has occurred.

Now, we have had a number of journalists that have begun writing a similar message. The Government Executive Magazine had a cover story on hollow government and the incapacitating consequences of continuing austerity, which was published a short time ago. This is in the October issue of this year.

We had Time Magazine in October of this year with a cover showing George Washington with a tear in his eye, and "Is Government Dead?" And it raises a question of whether we are even organized or set up to cope with this kind of a budget crisis.

I think many people across this country are beginning to believe that we absolutely, finally, have to change. I don't think anyone doubts that, but the question is what kind of change, and are we capable of making these changes. Are we set up, are we organized to make the changes, in your opinion?

You, above all people in Government, particularly with regard to our investigations from Congress from our end of it here—we depend upon you, and you look at this across the whole length and breadth of Government. Are we organized right now to cope with this?

Mr. BOWSHER. Mr. Chairman, I think it is a very dangerous situation here because the hollow Government really has happened, and I am afraid that it is going to continue to get more hollow, again, to a great extent because of this budget deficit.

We have done studies, what we call management reviews, of some of the major departments, and they were the basis for some of my remarks a year ago. Take the IRS, for instance. This is the department in our Government that we rely upon to bring in the revenue, $1 trillion, to support the overall Federal Government. We have systems there that go back to the 1950s and 1960s. We had the breakdown, 2 or 3 years ago, at the Philadelphia service center where they just couldn't even get the tax returns processed.

We looked at their personnel situation and found that they really are hiring three types of people: lawyers, accountants, and computer specialists. They are having a great deal of trouble hiring those three groups of people because of pay schedules and other problems.

What you have here is a department that has old equipment and old systems and is not able to attract the best people today to run that department. That is the type of department that is getting into trouble, and I don't think we have the plans and the investment—and it is going to take investment in people, it is going to take investment in systems—to get that department straightened out.

HUD was the same way. At HUD what we found was a pattern of lots of plans for new systems to get on top of problems, but those plans never turned into completed systems; they never got the job done. One of the reasons was nobody ever stayed long enough. Most of the appointees over there stayed about 18 months or 2 years, and then they would leave and somebody else would come in and they would change the plans one more time.

And so, at the end of a 10-year period, we had a department that was in disarray, and that is why, of course, Secretary Pierce reported that he could not assure anybody that his systems were on top of it, but it also was an indication that no progress was being made over there.

I think even at the Defense Department today, when we see this large build-up of excess inventories, when we see problems with some of the major weapons systems, I worry a great deal that we do not have the systems and the people to handle some of the technological issues that we are trying to handle.

A good illustration was that about 2 months ago we held a symposium at GAO on ADP systems. We brought in four representatives from private sector organizations that were big enough and complex enough to be comparable to some of our large Government agencies and large Government programs.

A comparison, I think, tells a lot. There is an organization down in San Antonio—in fact, Mr. Chairman, you might even have some of your insurance with them, that sells insurance to officers of our military services and retired officers. This is a very large organization today. In fact, they were saying at the symposium that, when they put the next addition on their building in San Antonio, their building will be bigger than the Pentagon.

Now, they have a lot of people and in the old days they received a lot of paper and they had a tremendous amount of trouble recovering the paper so that they could handle the phone calls and the inquiries as to where did this claim stand or other issues regarding their policy holders.

Some years ago, they decided they were going to computerize. They were going to get all the information into their computers electronically as the paperwork arrived, and they would get away from the idea that they had to hire college kids at night to go trace lost files. They have done it. Today every piece of paper that comes in gets into the computer and they can bring the information up on terminals at the touch of a button.

Now, we had the IRS officials at that same symposium, and they pointed out that every year they got 200 million returns sent into the IRS. They have to retrieve 40 million of them. They only accumulate 2 percent of the information electronically when it arrives.

In fact, if you go down to West Virginia, you will see some of the oldest systems on this tape system that the IRS still uses today for their main files on the American taxpayer. Actually, when they ask people to come in for an audit, lots of times they have to insist that you bring your returns because they can't find them for the past years.

So this shows the kind of difference between what a modern, large company dealing in paperwork is doing about their problems in a modern vein and what we haven't been able to do in the Government. We have the vulnerability of missed records.

I have often told this story. If you file your return in Boston and your return goes into a Boston service center, they then will do the basic processing. They put it on a magnetic tape, and truck that down to West Virginia. Then it goes into the central system.

If you have a refund coming, they then have to send some kind of a tape up to Philadelphia where the Treasury cuts a check for you. That is a 1950 technolgy that the IRS is using. All kinds of things can get lost in that type of a situation.

So what I am trying to illustrate with the IRS, and not pick on them, is just that, again our major departments have problems—I could tell the same story about the Social Security Administration. You know, today, the average American's savings is probably more in what he pays in Social Security deductions than what he puts in the bank.

Now, he expects his banks to have an accurate record. We have issued GAO reports that point out how inaccurate some of the earnings records are over at the Social Security Administration. Later on these will be used to determine what that person is going to get as a retirement check. It shouldn't happen; it shouldn't happen at all in this day and age.

Chairman Glenn. Is there any estimate as to what it would cost to set up a modern system for IRS, for instance?

Mr. Bowsher. They are working on that right now. They are trying to come up one more time with a new plan and new cost estimates, and it would be substantial. They are trying to account for and monitor $1 trillion I have always felt that, if IRS had a modern system of knowing where everything stood on your tax return, the American people would, one more time, be willing to pay their taxes, understanding that there is a system of integrity there; there is a fairness.

IRS now have their audits of taxpayer returns down to less than one percent a year. You know, most of the other countries used to come to America to study our system. They didn't understand how this country has such a high volunteer tax-paying society.

Well, one of the reasons was people thought the IRS had good records. They might get audited and, of course, some other features of the American society. But I think that that kind of capability is well known as having gone downhill now. If we were to rebuild with an investment in systems and people, even the revenue side of our budget would be enhanced.

Chairman Glenn. I was going to get to the IRS a little bit later. I will follow up a little bit right now on this because I think one of the things that you cite in your examples of a program lacking control is obviously IRS, and particularly IRS receivables.

Mr. Bowsher. That is right. That is another area.

Chairman Glenn. In the report, I believe you indicate in there that receivables have grown to more than $50 billion. That is a three-fold increase since 1981. Now, just for all we laymen, what do you mean by receivables, number one, as far as IRS goes?

Mr. Bowsher. Well, that is an amount where it is agreed that somebody owes the government money.

In other words, you are no longer in dispute with the IRS agent. There is an agreement that citizen "x" owes the Federal Government and the IRS so much money.

Chairman GLENN. In other words, these are delinquent taxes that people should have paid and have not paid? They just haven't paid?

Mr. BOWSHER. That is correct, that is right.

Chairman GLENN. And that is $50 billion?

Mr. BOWSHER. Fifty billion, and as you point out, Mr. Chairman, up by three times from what it used to be.

Chairman GLENN. Why aren't they——

Mr. BOWSHER. Now, I could give you another illustration that has been in the papers recently, and that is the Justice Department. A lot of the fines that are levied in our Federal courts go into a receivables system in the Justice Department.

You would think that we would have a good system over at the Justice Department that you could follow up on whether the fines have been paid. It is poor, it is very, very poor. Some of the people never hear from the Justice Department.

Chairman GLENN. Why is IRS not collecting these receivables? Do they just have to refer them to Justice? They can't take action, and them it bogs down at Justice? That is $50 billion.

Mr. STEINHOFF. One of the problems they now face is they are not really certain of the composition of the $50 billion. The records aren't in very good shape. They are now having a series of studies done to really take a hard look at the receivables and see where in the pipeline they are bogging down.

Some are a result of a downturn in certain parts of the economy, but you need to have baseline information that show you where you are having collection problems, and you need to have that on a consistent and constant basis.

Chairman GLENN. I know, but if they have sent them a bill and they have looked at the IRS return, the income tax return or corporate return, either one—they have looked at that; they have said here is the tax that is owed. They send a bill out to the people, and then what happens at that point? It is just ignored?

Mr. BOWSHER. Sometimes it is ignored; sometimes they send another bill. But what you don't have—Jeff is absolutely right here, and it is the same problem we saw at HUD—is an aging of your receivables as to what are the oldest ones, where are they located, what is the follow-up process and everything like that.

We found exactly the same thing at HUD, and that is when these housing losses started to appear. We didn't have monthly reports; we didn't have monthly reports telling us what States, what cities, what areas are getting into trouble. And that is what you have to have if you are going to run a big financing operation.

So, again, Mr. Chairman, to go back to your opening remarks, a lot of people don't think accounting is important enough to make the investment needed to have it done right. But when you are running these large programs and you have a weak accounting system, it is hard to take appropriate actions because you don't have the right information.

Chairman GLENN. Are the ones referred to Justice only the ones that would have some criminal connection with them?

Mr. STEINHOFF. Yes. IRS has got a whole host of collection tools, far more than the rest of the Federal Government has.

Chairman GLENN. That would be the bulk of the $50 billion?

Mr. STEINHOFF. The $50 billion represents amounts owed IRS, some of which have some criminal connection with them. One of the things you have here is, by every measure, a tremendous increase in IRS' workload over the past 10 or 12 years, and a very flat organization. They came in every year and said our budget is fine and we don't need more people, and the facts are they didn't have the systems in place to use modern technology and they didn't have the people to get the job done.

Chairman GLENN. It has been a false economy, then?

Mr. BOWSHER. I think that is right; I really do. And I think again, like in the S&L crisis, when the people went to get more auditors when they realized they were starting to get into trouble, again this large budget deficit is such that people are saying, oh, no, go away, see if you can't do it with your existing staff. And as Jeff points out, the IRS was in the same situation that they just were not given additional resources to get the job done as the workload went very much higher.

Chairman GLENN. We used to have a rule of thumb that was talked about—I don't know how valid it was—that each IRS agent got his own salary and keep back five times over, on the average.

Mr. BOWSHER. Yes.

Chairman GLENN. Is that a valid figure?

Mr. BOWSHER. Yes, we think so. The GAO has testified on that several times.

Chairman GLENN. And yet the last administration cut back on IRS agents, didn't they? Didn't they cut the budget over there?

Mr. BOWSHER. They did up until the last, and I think there was one year, Jeff——

Mr. STEINHOFF. One year.

Mr. BOWSHER [continuing]. Where they did add some back because things were getting into a serious situation.

Chairman GLEN. It is an obvious area we need to still get into. Let me talk about some of the high-risk lists. This summer, OMB asked the agency deputy secretaries to make a fresh assessment of the internal controls and audit follow-up at their agencies. Following their reports, OMB prepared lists of high-risk programs, they called them, those most vulnerable to fraud and waste.

In your judgement, how good a job a OMB done in identifying where the risks are and where the next HUD may be?

Mr. BOWSHER. We think they have done a reasonably good job. We have looked over those lists and we see a lot of the same areas that we are worried about based on past GAO work. And so I think they are going after basically the right areas.

Chairman GLENN. I understand that you and GAO are now also compiling your own independent list of the top 10 or 12 most vulnerable programs. Can you tell us which programs are going to be on your list?

Mr. BOWSHER. I can tell you some of them, Mr. Chairman. We aren't quite complete yet as to which are the most vulnerable, and one of the things that we are——

Chairman GLENN. How similar will your list be to OMB's?

Mr. **Bowsher**. It will be fairly similar. I can give you four or five illustrations right now. At the Department of Defense, as you know, we have reported on how, in build-up in the early 1980s, we doubled inventories from $45 billion to $90 billion.

But more distressing is that the slow-moving inventory went from $10 billion to $30 billion. We have three times as much slow-moving inventory today than we had prior to 1980.

Chairman **Glenn**. That is what is previous hearings I believe we have referred to as long supply. Is that it?

Mr. **Bowsher**. That is right, that is correct. We feel that that is an area of vulnerability when you have inventories like that stashed in warehouses and being moved back and forth and not used. That is an area that we think we should look at both for the excess inventory and also the vulnerability.

The second area is one we have already talked about, and that is the IRS receivables. We think this is an area that needs an extra look. Medicare is another area. One time, I was testifying before the Ways and Means Committee recently and one of the senior Congressmen on that committee asked me how many people we have working on Medicare fraud. And I said, Well, I didn't know how many on Medicare fraud, but I knew we had about 200 to 250 people working in health care programs. He said that is not even enough for my district, and we feel that this is a high risk area.

I think this also illustrates a problem that I might explain right now. Many of the Government programs today are not completely run by Government officials, and, therefore, the money is not completely under the control of Government systems and controls.

These program are partially out in the private sector. I think the "Robin HUD" situation is a good illustration where HUD moved part of the processing into the private sector and then didn't properly monitor just how the money was coming in. So, she was able to literally take the money in and then do something that she wanted to do with it rather then send it into the Federal Government.

We have quite a few programs—Medicare is one of the good examples—where much of the processing is done in the private sector. We believe that one of the extra efforts that we are going to try to do in the next year or two is start to look at some of the controls in the private sector over what are basically Government programs. That is one of the reasons that we have brought to GAO Don Wurtz, who is on my left, from the private sector to give us increased capability in this area.

Chairman **Glenn**. Do you have an estimate of what the bill on Medicare—you mentioned long supply items have gone up $10 to $30 billion; IRS, $50 billion. Medicare—do you have a figure on that that you estimate?

Mr. **Wurtz**. Mr. Chairman, in 1987, we issued a report that indicated that Medicare lost in 1985 alone $527 million on primary payers not paying their share. There have been estimates that that could rise to as much as $10 billion, so we are talking significant amounts of money here where we have to actually look into the private sector to see what procedures are being followed in that area.

Chairman **Glenn**. Okay. What else is on your list, Mr. Bowsher?

Mr. BOWSHER. One of the other major concerns is the Pension Benefit Guaranty Corporation for which, like HUD, we have not been able to do a financial audit for a number of years. I am pleased to say that the new head of the Pension Benefit Guaranty Corporation has personally called me and said that he wants an audit. We are sending our people in to see if the systems are in good enough shape that we can start a financial audit.

But I think the pension guarantee program is a lot like deposit insurance in that if major corporations go under, the problem falls into the insurance fund that the Government has set up. If that insurance fund is not adequate enough for those situations, the problem it falls right back onto the American taxpayer.

I think you might remember, going back quite a few years now, that in the Chrysler bail-out this was one of the issues that everybody debated. If there was a not a bail-out, then the new, at that time, Pension Benefit Guaranty Corporation could have seen its whole fund wiped out.

And I think another case is LTV Corporation, which is still being litigated in the courts. It is at the Supreme Court level this year.

Chairman GLENN. I remember that one very well. I was much involved with that one.

Mr. BOWSHER. So these are large situations that if we ever got into a recession and we had a number of major corporations that could not make good on their pension programs, we have a high vulnerability. To have a program like this with records that cannot be given an annual financial audit is a terrible situation.

Chairman GLENN. Is the pension guarantee fund—do you have any potential liability figure you can give us on that one?

Mr. BOWSHER. I don't think we can do that until we do the financial audit, Mr. Chairman. In other words, that is like HUD a year ago. I was not able to give you any estimate at that time, but once we get the audit process through, we probably could report back to you.

Chairman GLENN. All right, good. Any others on that list? You had defense long supply, IRS receivables, Medicare fraud, and so on, pension benefit guarantee fund. I believe that is the first time you have announced those, is that correct, as areas of potential——

Mr. BOWSHER. We have announced the pension guarantee one previously as one that we were worried about, but I think——

Chairman GLENN. Those are in addition to OMB's, or that would be a different priority list from what OMB has given us which we released previously, is that correct?

Mr. BOWSHER. That is correct. There might be some overlap there, but they will not be doing financial audits. Another major area I would like to get into here is the student loans. That is one that we have worried about for a long time. I can give you a number on there that might be as much as $5 billion that we are worried about.

Chairman GLENN. You are still working on the list, as I understand it.

Mr. BOWSHER. We are still working on the list, and I would hope that by January we could send you a copy of the list. We have a commitment to send one to Chairman Conyers over in the House, and so we are hoping to have this list for both committees before the Congress comes back in January.

Chairman GLENN. I would request that we get copies, or even working drafts, or whatever, so we can get going on that as early as possible.

Mr. BOWSHER. Sure.

Chairman GLENN. And we might want to have another hearing on it to get more information on it at that time in January or whenever you have it ready. We have been rethinking a bit about how this Committee and its Subcommittees should proceed in our general oversight mission that the Committee has. That kind of a list would be very helpful to us. Mr. Darman put together his high-risk list; that helped us a lot.

Mr. BOWSHER. Sure.

Chairman GLENN. And we are working now on a series of hearings next year in which we will get into some of that. Your listing of these things here this morning for the first time is another—that is a help to us, and as you follow up, we would appreciate any information you can give us on that list because that helps us in our oversight function.

Mr. BOWSHER. We would be pleased to do that.

Chairman GLENN. Thank you.

Let me read a quote from your testimony regarding credit assistance and insurance programs. We touched on those very briefly. "The recognized losses from these programs over the past several years total in the $200 billion range. We anticipate additional tens of billions of dollars in future losses in other programs." Now, that is a rather staggering comment in itself, and it sounds like a warning signal.

Now, were these the ones that you just listed—are these the ones you were referring to or are there others that——

Mr. BOWSHER. Those were the ones that I listed early on there, with the Ex-Im Bank and the Farmers Home and the foreign military sales. We came up to a preliminary list of maybe as much as $80 billion, and we thought it could easily be $100 billion.

Chairman GLENN. You had $80 billion and it could be $100 billion on those, and then I don't know what this last list totals up to. That would be a potential of somewhere between $70 and $95 billion on this last list, then, is that right? So we are talking maybe a potential here of somewhere around $125 to $150 billion, if I am adding this up correctly, is that right?

Mr. BOWSHER. I think it could be in that range. I wouldn't add that full amount on the inventories of Defense, but I think there are probably items that we don't have a handle on yet. So I think the $100 to $150 billion range is not unrealistic.

Chairman GLENN. And one of the prime things you are talking about here is we are not set up to really take action on this. We don't have the systems to really go after that, and it is some $150 billion. Yet we are not set up to go after it.

Mr. BOWSHER. That is correct. In other words, what we are identifying here are areas and programs where we have weaknesses; we know that we have weaknesses. Some of the weaknesses are so bad, we can't do an audit, and it is going to take an investment both of people and of modern technology to get on top of these issues.

Chairman GLENN. What we are going to need as we go along, too, if we can, is an estimate from you and from these agencies and from OMB as to what it is going to cost to put modern systems in so we start correcting this and keep up with it.

I would be quite happy to go out and try and get the systems if we had the figures there and could detail them so we could put in a piece of legislation that says here is what we have to do across the board. This is the Committee that should be doing that, if we can get the figures on it and your estimates on it. Maybe we ought to just make some wild estimate, put it in anyway, and debate it out on the floor.

Mr. BOWSHER. That is true, but I think we have to do it also by individual area, Mr. Chairman, because I think one of the things that we have to be very careful about is that the investment that is made here in these systems is done well. It has got to be monitored to make sure that we get them working properly.

Chairman GLENN. Do you have any wild, ballpark figure you could give us this morning, subject to modification later on, obviously, of what it would cost to put systems in for all these many different things we are talking about here? These are enormous amounts of money.

Mr. BOWSHER. I really don't. I have worked a lot in my career in the systems area, and, until you have what I call an architect's drawing of what the system design might be, giving an estimate is just too risky. I could well mislead you, and I don't want to do that today.

Chairman GLENN. One other example here: FHA losses that you note in your testimony. GAO's recent audit of the Federal Housing Administration showed losses of some $4.2 billion. Now, the administration's financial reports only showed losses of $858 million. What is the difference there?

Mr. BOWSHER. The difference was that they had not booked any of the losses for the large co-insurance problems that they had, and they had not booked some of the losses that they were facing on the delinquencies of the loans and the housing that they had taken back.

I think this raises another very significant issue in the Federal Government, and that is that I think you have got to not have a strictly cash-based budgeting and accounting system. I don't think we need accruals on a lot of little things because of the magnitude of the Federal Government.

But I think that it is awfully important when you have large, multi-billion dollar losses that you don't recognize until we have to write a check 2 or 3 years down the road. You have got the loss at that point in time; you should recognize it, and therefore it will tell you just where do you stand financially on these programs.

I think the HUD $850 million was a result of not recognizing anything until they had to write a check, and it just wasn't the true picture of those funds at all. We weren't able to give a clean opinion on that audit, I might point out, there are still several areas that are being investigated both by HUD and the IG and ourselves that might even drive the $4.2 billion loss higher.

Chairman GLENN. I am not an accountant, obviously, but what we need, it seems to me, is something like we used to use in big projects, a pert chart or a how-goes-it chart, where you have the Government's liabilites and then a time frame in which those liabilities might or might not come up, and the total of what they are liable to be at any particular point. And then you monitor them as you go along, depending on which ones have the largest potential liabilities to the Federal Government.

Something like that might be helpful, if we could sketch that out so everybody could understand it better, because it is one thing to list them like we list them here and try and make a total on it, but the question is how do we do something about it.

Mr. BOWSHER. That is right.

Chairman GLENN. It just seems to me you need to set that down on a time basis. Maybe we could work together on something like that.

Mr. BOWSHER. Yes, I would be pleased to do that because we do need that and, of course, that is what you generally get from financial statements. You get a set of liabilities and then, hopefully, the decisionmakers will have programs in place. That is what we have not had in the Federal Government and it is what we have mandated for all the State and local governments. We have mandated it from Congress for the major corporations of this country, and it is time that we mandate it for ourselves at the Federal level.

Chairman GLENN. If we had had financial statements, as you say, would that have led us into a better estimate of the FHA problems?

Mr. BOWSHER. Yes, it would have.

Chairman GLENN. The S&L disaster; the present estimate of the taxpayers' cost of the S&L disaster is—one estimate is $139 billion; I have seen estimates as high as $165 billion. I don't think anybody really knows what may happen at this point.

Mr. BOWSHER. No; I think, though, the figure I generally use is $250 billion, in total. The $139 billion really is what is estimated now that the American taxpayer is going to have to pay through taxes. So it is huge.

Chairman GLENN. And that would come liquidation of assets taken over?

Mr. BOWSHER. The $250 billion would come from that and taxes, yes.

Chairman GLENN. Okay. What assurance do we have that adequate controls are in place to ensure that this money is not wasted or ripped off?

Mr. BOWSHER. Very good question, Mr. Chairman, and that is going to also be on our list of the 10 to 12. I can assure you that we will be looking at the RTC, the new entity set up for this great bail-out. We will be monitoring and we will be doing a financial audit, as the legislation requires, on this because the potential for fraud and waste and mismanagement there is really significant. We are going to try to keep on top of it.

Chairman GLENN. Is there a plan in the administration now to do that, to set up adequate financial monitoring in the RTC?

Mr. BOWSHER. They are in the process of developing those plans, and we will be reviewing them for the Congress.

Chairman GLENN. That is not too comforting because they are already paying out the hundreds and hundreds of millions of dollars right now.

Mr. BOWSHER. That is correct.

Chairman GLENN. And what you are saying is they don't have the monitoring system really in place yet.

Mr. BOWSHER. They are using the FDIC system to get started.

Chairman GLENN. Are they adequate?

Mr. BOWSHER. Those have been pretty good. We have audited those in the past.

Chairman GLENN. Okay. The Financial Integrity Act process; I understand the agencies' Financial Integrity Act reports vary considerably in quality and thoroughness. Some, like the Department of Agriculture, reported 130 weaknesses as I understand it. Others, like NASA, before the *Challenger* explosion, reported few, if any, problems.

How do we get top management commitment to run a rigorous program which identifies items significant enough to be of interest to the President, the administration, and the Congress?

Mr. BOWSHER. I think that is a very significant issue that we all have to deal with. Unless you summarize the major problems and get that to the decisionmakers' attention, both in the Executive Branch and the Congress, then the reader gets overwhelmed by 130 weaknesses, especially when these weaknesses are written up in such bureaucratic language that it is very difficult and very tedious to read these reports.

I think one of the lessons that we should learn from the HUD situation is that the IG reports have got to be highlighted. One of the things we did a few years ago at GAO was to redesign our report package to get a better executive summary up front.

And I think the reports that come to the major decisionmakers have got to have those kinds of summaries so that you know what are really the most important problems, what should be done about them, and what has been done about them. That is going to be important for the Executive Branch to do, and then I think it is important for Congress to hold hearings.

I think if we get the reporting done properly, the pressure point has to come from oversight hearings here at the Congress. If we don't have that, I am convinced, after many years now here and working in these areas, there are just too many people that turn it into a paperwork exercise. They crank out the reports, they put them on the shelf, and they really don't get the corrective action accomplished.

I think that Congressional oversight in an annual hearing based on an annual report from the Cabinet officer or the head of the agency is an essential ingredient to getting these problems straightened out.

Chairman GLENN. Well, okay. I would agree with you up to a point, but aren't the Cabinet officers themselves part of the problem?

Mr. BOWSHER. Yes, they are.

Chairman GLENN. The average Cabinet officer here serves between 18 months and 2 years, and they are gone. They come in as political appointees to get their ticket punched so forever they can have in their dossier that they were Secretary of whatever, and then they are gone. They ride around in their limousines, and that is fine. I wouldn't try and take their limousines away from them.

But it is, at least in part, an honorary position, and they don't come in with the idea of straightening out or really taking a firm hold of that Department of Government. They are here to not make too many waves because they were political appointees to begin with, and that is fine.

But how do we get over that hurdle of people who are in here for a short period of time? They don't want to root out things, and make a big fuss while they are here. It only makes the administration look bad. They want to get in, get their ticket punched, in effect, and get out of town. How do we get around the hurdle?

Mr. BOWSHER. It is a major problem in the Government because when you have too much turmoil at the top. As we pointed out earlier, a lot of times the systems plans get changed. Even the reform efforts get changed so frequently that nothing gets accomplished. I think you have put your finger on a very tough problem.

One of the things to try to handle it is you have got to build the infrastructure underneath them to have the reports, to have the information prepared by career people who are going to be there for a longer period of time and who are qualified.

One time I showed our annual report to a former Cabinet officer who said, "you know, when I came into that Cabinet position, I wish somebody had come to me and been able to say there is the annual report for last year, here is where things stood, here are the problems." I think that would be very helpful.

But there is no question that this great turnover of the Presidential appointees is a major problem for our Government. And one of the things I recommended to the Volcker Commission, and they picked up on it, was a substantial reduction in the number of Presidential appointees.

When I served at the Pentagon in the late 1960s, we had six people in the Secretary of the Navy Department. Today, they have three times that many, I believe, and in other Departments we have all kinds of Presidential appointees where we used to have maybe a half dozen.

Chairman GLENN. It is a real problem because we elect a President to lead the country on what that person has talked about during the campaign. Then you can't deny him, or her, someday, the people to put those programs into effect. So I don't know how we make that balance, but right now I think it is tipped over too far in one direction.

Mr. BOWSHER. It is tilted too far over there, and we have just got too much turmoil at the top.

Chairman GLENN. Yes. CFOs would do a lot toward making sure we have this come uphill; all the information comes uphill and becomes public and is brought to our attention on a timely basis.

Before we get on with other questions, can you tell us just what you see a CFO doing, because there is confusion. I am asked all the time, you advocate a CFO; what would he do. Okay, we have a CFO; he is the chief financial officer of Government and he has his subordinates in all the departments and the agencies over there.

When he walks into his office in the morning, what would be his function? What would be his mission?

Mr. BOWSHER. Right. His mission should be that he ought to get agency financial reports on a monthly basis, just as we required in New York City when we gave them that loan. We said you have got to send down to the Treasury Department of the Federal Government a monthly report on where the city of New York stands. And they were able to do that, and that was one of the reasons we were able to monitor the program so successfully.

We should have the same thing coming in from the 20 largest Departments of the Federal Government. That includes all the Cabinet Departments and major agencies like NASA, and that includes 95 percent of all your Federal dollars. So he should see these reports on a monthly basis.

Then as he sees problems developing such as these we have talked about today—the IRS receivables are building up, the inventories are building up at the Defense Department—he should request—just like the chief financial officer of a State or a major corporation—some additional information and additional studies be made as to why it is happening. Why can't the Justice Department collect their fines? These are the kinds of questions that should be sent out. You have an inspector general organization in place today in the Federal Government. They can do a lot of additional studies if you have got the total picture.

Now, one of his other major duties is——

Chairman GLENN. But let me digress just a moment right there.

Mr. BOWSHER. Yes.

Chairman GLENN. The IG's would be—if we get a CFO in, then he would be doing this oversight that we are requiring IG's to do in some respects now. At that point, the IG's then could be more—they could concentrate their efforts more on wrongdoing and ferreting out some of that. Is that the way you would see it developing?

Mr. BOWSHER. Well, one of the big problems today that the IG's have is the same that GAO has. The records are so poor that when you go out to do a study, you spend half your time trying to put the facts together, the data together, before you can really do an audit.

And it seems to me that, if we get this CFO structure in place, the information should be there. We should have a lot of savings and allow the IG's to spend their time much better.

Now, if I can just make one more major point on this CFO structure, we have weak systems today. One of the CFO's major jobs would be to get the systems fixed up, and that is going to take an investment of time. You are not going to do that in the next 30 days. He has got to monitor to see if HUD is getting its systems in place.

In other words, we are not just relying upon the new Secretary of HUD; we are also relying on the chief financial officer. He should know the status of the systems at HUD, Defense, Transportation, and Agriculture, and should make sure that the systems are in place and that they are sending over good information.

One of the other things we are doing right now, Mr. Chairman—I have mentioned it to you before—is an audit of the Air Force. This is the first time we have ever done an audit of one of the three military services. We are finding major problems. We are finding the same thing we normally find in a large Government agency that has not had to have audits. They send up year-end balances on their financial reports to Treasury that are just dead wrong. And so, you know——

Chairman GLENN. In what respects, on major weapons systems, or in what areas?

Mr. BOWSHER. It is practically in every area, we have found.

Chairman GLENN. In every area?

Mr. BOWSHER. In just about every area, whether you are looking at inventories, whether you are looking at base operations.

Chairman GLENN. And is the Air Force just falsifying information on it? Are they just making it up?

Mr. BOWSHER. It is clerical laziness as I often describe it. It is the same thing when I did the first review in New York City back in the mid-1970s, and when I did other work on some of the major States and cities in this country. It is the same type of problem. If you don't have a routine financial reporting of the status of where things stand, and have it independently audited by somebody, then you get into lazy habits.

I can remember in one large city in this country that I did an initial financial review on. They sent last year's receivable balances forward. We have seen those kinds of things in some of this Air Force auditing.

Chairman GLENN. I know this is an ongoing audit of the Air Force. Do you have any examples you can give us this morning, or should those wait until later?

Mr. BOWSHER. I think we had better wait until we have it complete, but I think I have given you the flavor of what we are coming up with. It is going to be a series of problems that will indicate that the financial center in Denver—which is their big finance center—is not getting the proper information from the components of the organization, and is in turn, then, sending this bad data on to the Treasury and people aren't doing anything about it.

Chairman GLENN. When will that report be available? Do you know? When is your work on that Air Force audit going to be completed?

Mr. BOWSHER. We are hoping to have the first report out in January, February at the latest, so we are pretty close. We have been working on it for 2 years.

Chairman GLENN. You are invited back.

Mr. BOWSHER. Thank you.

Chairman GLENN. Have you looked at the other services?

Mr. BOWSHER. No. In fact, we decided we would do the Air Force because we thought they had the best records. We expect to see more problems in the other two services.

Chairman GLENN. And you anticipate from what you know about the other services that they will probably be worse than the Air Force, then?

Mr. BOWSHER. That is correct; that is our general feeling.

Chairman GLENN. Do you plan, then, to follow on with the other services, in turn?

Mr. BOWSHER. Yes, we do.

Chairman GLENN. And how long does it take to run an audit like that?

Mr. BOWSHER. Well, it takes about 2 years to do the initial review. We are going to try to do one more at the Air Force and then get started on the Army. We plan to do the Army next and do the Navy last.

Chairman GLENN. Health and Human Services IG Dick Kusserow reported to us that in his agency it is the IG's and the auditors, not the managers, as intended by Congress in the law, that are identifying material weaknesses.

Would you first identify material weaknesses—what is the definition of material weakness?

Mr. BOWSHER. Well, I think a material weakness would be where you have gone through and done a risk assessment and you have said that you are not sure that the systems and the controls that are in place for that program area are good enough that you can say that you think you have it under control. So, therefore, you would list it as a material weakness.

Now, if you remember, the Financial Intergrity Act requires the managers to identify them and the auditors to review what the management is coming up with. What Mr. Kusserow is pointing out there is that in some of the departments, management is not that involved in this process, and so the IG's, through their work, are coming up with the problems.

That is better than not coming up with the problems. In fact, I think it does show how important the IG's are. But it also indicates why we have got to get management involved. I might point out that I met with Dick Darman in August, after the HUD situation broke, and he is in agreement with me that that is one of the reasons why this annual report and annual audits are important. They put the pressure on the agency head or on the management to do something about it.

Some people want to do just what I call program audits from time to time on the more vulnerable areas, but I am a big beliver that you have got to do agency-type financial audits and financial statements because, if you don't do that, management has a tendency to think, well, maybe I have got a problem here, maybe I have got a problem there, but overall everything is okay. Overall, generally, everything is not okay, and that should be reported every year.

Chairman GLENN. If you have a CFO, they get those financial reports in and then you know what is going on.

Mr. BOWSHER. That is exactly right.

Chairman GLENN. How effective are the Financial Integrity Act requirements as an early-warning system? Are we identifying problems early enough that we can begin corrective action before the problem or its costs get out of control?

In other words, is this a good system that we have set up? Does it need modifying? You have pointed out quite a number of areas here this morning in which previously these things have not had adequate systems monitoring them before. Is the Financial Integrity Act adequate to do the job of an early-warning system?

Mr. BOWSHER. I think it is adequate as basic legislation to get the job done, but as I pointed out, it is awfully important that we get better summaries of these reports so that the key decisionmakers at the top and the Congress know the most important problems that we should be dealing with. Some kind of prioritizing of the problems is a necessary improvement in the overall process, but that can be done without amending the law.

Chairman GLENN. You have to have that kind of information to submit an adequate budget, or a budget that is a truthful budget, anyway. Now, GAO has strongly recommended, I know, linking the Financial Integrity Act internal control review and reporting process with the budget process.

The next round of agency head reports to the President and Congress are due December 31st. Do you believe that Director Darman is taking action to link the fiscal 1991 budget process to this review process?

Mr. STEINHOFF. We have been told that he will do that, and that OMB has been very responsive to the whole host of recommendations to improve the process.

Mr. BOWSHER. Yes, and I think it is very important that that review be done as part of the process.

Chairman GLENN. It it is not done, then the whole thing becomes useless, sort of an exercise in whatever?

Mr. BOWSHER. Well, that is right. It becomes an exercise off on the side that the top people are not involved in. That is exactly what happens.

Chairman GLENN. If it doesn't impact on the budget that is submitted to us here, then the whole thing is sort of useless.

Mr. BOWSHER. That is right.

Chairman GLENN. That is the bottom line.

Mr. BOWSHER. That is exactly right, Mr. Chairman.

Chairman GLENN. I introduced legislation in the last Congress along with Senator Roth to create a CFO structure, and it would be a Government-wide CFO in the Department of Treasury and CFOs in each of the departments and major agencies.

We have tried to develop a consensus among key factors in this past session for getting a legislative start on the chief financial officer legislation. We started that with Mr. Darman's confirmation proceedings, and Senator Roth and I have had a number of conversations with representatives from the administration and the House.

I have thought—and we may be at variance on this, I know, from some of our past conversations—I have come to believe that perhaps this should be in OMB, with this idea in mind: OMB is the one spot in Government where all the budget comes together at one spot to be haggled over and to be put in final form before it is submitted.

It would seem to me that that is the spot where a chief financial officer should be, and I know you indicated earlier, I believe, in your testimony, or I think it was earlier, that you felt that perhaps that would not be the place where it would have adequate resources to do the job and the clout to do the job.

Now, OMB has developed into what I think—you may disagree with this, too—I think the head of OMB is the second most powerful man in Government, second only to the President himself, because that is where the whole thing comes together to be recommended to the President. I think that has more to do with what we do socially, defense, international, the whole thing. That is where all the budget comes together, and that is where we make the money available to do whatever it going to be done.

So I have to sort of come around to thinking that OMB is where the CFO should be. Now, what are your thoughts on it at this point?

Mr. **Bowsher**. Well, I wish I could agree with you, Mr. Chairman, I truly do, but I do have concerns. That was the rationale for setting up the management part of OMB, and that has become so important. It does have the budget clout.

But when we look back at the last 10 or 15 years, we don't see them using that clout, that budget clout, to improve the financial management of the Federal Government. They created this chief financial officer 1½ years ago, I think, to stymie the legislation that you had introduced.

And you said at the time that you were concerned about it, and I think your concerns have come about. We have not seen the resources attached to it, and it is a shame because I think we have been reporting all these problems and we don't have progress.

Now, if a Director of OMB really wanted to do this, really wanted to get on top of it, and was willing to put the resources in at OMB, or some working relationship with Treasury—and the only worry I have there is splitting authority with resources—I think the job could get done.

I think the true thing is that Treasury and OMB and ourselves—if we could work together—could get this job done. The unfortunate thing in the last few years since I have been in office, at least, since 1981, is that we have not been able to get the leadership in the Executive Branch willing to work on these financial management problems and to put the resources behind them.

Chairman **Glenn**. Is there any thought that it should be completely independent of everybody; it should be like NRC with reporting requirements in both directions?

Mr. **Bowsher**. Yes, some people have advocated that. I have always said that that would work. The only problem I have is I am not sure that people want to set up one more agency, one more separate, autonomous thing. Australia has pretty much done it that way, and I think it is one of the options that should be considered.

Chairman **Glenn**. I made the focal point of Mr. Darman's confirmation hearings that I conducted here—I made the focal point of those hearings putting the "m" back in OMB. We changed from Bureau of the Budget back many years ago and called it OMB, and it has been OMB in name only. Management has received very, very shortshrift over there through the years.

And we made that the focal point, and Mr. Darman says he is—and I think he has moved. I think he is sincere in wanting to put more of the management function back in there. I hate to undercut him by then saying, well, we will put the real management tool, a CFO, off someplace else. If we were to do that, I think we would have to maybe change some of the responsibilities. But I don't know. Those are things we can save for later.

Mr. **Bowsher**. Yes. I must say, Mr. Chairman, too, that my meetings with Mr. Darman have been very constructive. He seems to understand the problem. He seems to want to do something about it, and I am more encouraged than I was in the early part of this decade.

Chairman GLENN. Yes. I am, too.

What authority should the CFO of the United States have over individual agency CFOs? For instance, implementing accounting systems—and I go back to earlier testimony that you have given us over the past couple of years. I think we started out—you had identified some 400 different accounting systems in the Federal Government. I don't know how people design 400 different systems of accounting systems.

And then it was narrowed down a little bit. You said, well, major systems are about 200, and people thought we were making great progress, I guess, because we only had 200 major systems. Now, that just has to be fundamental if we are going to have accounting throughout the Government, and CFOs that can even talk to each other on the same basis and present financial statements on the same basis.

What kind of progress are we making in that? Would a CFO, for instance, as you see it, have full authority to move to implement an accounting system for this country that is the same for all departments?

Mr. BOWSHER. I think one of his major roles is to get that architectural plan put together where we get rid of most of those 400 systems. Those systems are old, they are antiquated. Really, a lot of them are an outgrowth of World War II, and what we need is modern systems in a few locations.

I don't think we can go to one central system because the Federal Government is too large, but we could get down to a relatively few number of what I would call finance and accounting centers run by various departments, and we also could get away from this idea that every small, little agency has to do its own accounting, which wastes tremendous resources. That whole area of consolidating and modernizing the systems is one of the major responsibilities for the chief financial officer.

Chairman GLENN. How much of this should we do in Government and how much out? I know the major accounting firms are just champing at the bit. They write letters and all sorts of things, and they publish; they have their meetings about what a great job they could do if they were just permitted in to do the auditing of different Federal accounts. Is there a role for private accounting in this?

Mr. BOWSHER. I think there could be a role for private accounting. I think the finance center that the Government runs in New Orleans is a good example of what the Government can do.

I think that one of the options that should be considered would be whether some private firms might run a comparable center. It wouldn't necessarily be the private accounting firms, but it would be some of the firms that do what is called facilities management type accounting systems.

I think it wold be worth trying some of the centers in the private sector, so that you would have both centers run by Federal Government people and some by private people, and then just see what works best.

Chairman GLENN. I would think we might be able to try that out in some of the smaller agencies and see how it works.

Mr. BOWSHER. Sure. You know, we could get down to relatively few, and I think there was some progress made here in the last decade by OMB and the Executive Branch on reducing the number of payroll systems. But we don't need all the payroll systems that we have. They are very repetitive.

I think your colleague, Senator Lautenberg, was head of one of the biggest companies in America on payroll systems, the ADP Corporation. The reason that corporations went more and more to farming that out to a corporation like that was that it was a repetitive system. When the tax laws are changed, they can make a change in their central system and process payrolls for thousands of corporations and city and State governments.

So there is no reason why the Federal Government can't avail itself of those kinds of capabilities that we have in this country and save itself all kinds of problems and expense by running individual systems.

Chairman GLENN. We have a member of this Committee, Senator Pryor of Arkansas, who heads up one of our Subcommittees. He has taken a particular interest that would be—I won't say it would fight that idea, but it would express great concern about that idea, were he here this morning to express himself, I am sure, because he has seen us doing so much outside consultant work that we waste many, many tens and tens of millions of dollars on—outside consultant work doing studies that overlap each other.

And he has taken the lead in trying to cut that down, to his everlasting credit, and has done a good job with it, and I am sure he would want to express a note of caution on exactly how we do this if we are going to start contracting outside because that could be a tremendously expensive operation, depending on how we went into it.

Mr. BOWSHER. Yes, and I think what should be done is a real cost-benefit study to consider if it is better to do it inside or outside. I don't think we should rush to putting all this out in the private sector, but I think there are some options that could be considered. It really isn't consulting as much as it is just running centers that can process payments, can process your payroll.

Even at GAO, I have moved most of our accounting down to the finance center in New Orleans. When I arrived at GAO, every time there was a payroll change, we had to invest in our payroll system. Every time there was this kind of any kind, we had to go change our payment system. And so today we don't do that. We just let the finance center that the Agriculture Department runs down there do it—and we get the monthly reports.

Chairman GLENN. We are all familiar with regular financial statements—profit and loss, bottom-line, balance sheet, and all those things we are familiar with in private business that you have to deal with.

Do you see any difference in a Government organization as to what a financial statement should be because we are not a profit-and-loss organization in Government? We provide services mandated by law. Is there a different kind of financial statement we are talking about, or how do you define the kind of financial statement that we are talking about?

Mr. BOWSHER. Definitely, there is a difference between the Federal Government's financial statements and private sector business statements. Our statement should be tailored to the needs of the Federal Government and the decisionmakers in the Federal Government.

Chairman GLENN. Well, are there substantial differences, though, or would it basically be the same general financial statement?

Mr. BOWSHER. Well, there are certain differences. I think one of the major things you want to do in Government is always get your reporting so that you know how you are doing against the budget, because the budget is so crucial, as you pointed out, in running the Government.

Another major area, I think, is the property. Much of the property in the Government, you are never going to sell, so it isn't worth depreciating. Some of the property is income-producing, so you probably do want to depreciate it. So you have got to look at the different components and set it up.

A fair amount of it would be similar to accounting in any entity, but you have to do it from the vantage point of what do you need for the Federal Government. We have been doing that in the State and local governments. You know, we had a mess in the State and local governments of this country prior to the New York City fiscal crisis in 1975.

I have always said that the New York City fiscal crisis was to State and local government what the stock market crash in 1929 was to our private corporations. In other words, you finally recognized you had lousy accounting, poor financial reporting, no audits, and we have gotten that straightened out.

And they have an organization called the GASB, the Government Accounting Standards Board, that has helped put their standards together. They have annual audits today. So we have made a lot of progress. The Congress and this Committee, Mr. Chairman, passed the single audit legislation a few years ago. We have just made a tremendous amount of progress there.

Again, one of the issues back in the mid-1970's was: Was this going to look like the financial reports of business? We don't need those in Government. But we have gotten over that hurdle now. People are confident that we are moving toward designing the systems and the statements that we need for Government, and we can do the same at the Federal level. It just isn't hard to do at all.

Chairman GLENN. Putting this in across the board, setting up a system like this for the whole Federal Government, is not going to be inexpensive, but I would presume that you feel that the benefits on a cost/benefit ratio—we are going to save more in the long run by far than it is going to cost to set up the system.

Mr. BOWSHER. I think we can save billions.

Chairman GLENN. Do you think if we set up a system like this it should be—can we go to it at a date, time certain, or should it be phased in? Should we have a CFO and have him work, then, agency by agency, department by department, to implement this and phase it in, or should we do it on a time certain?

Mr. BOWSHER. I think we should do both. I think we should have a time certain as to when you want it in, and then ask him and the people working with him to give you a phased approach as to whether he can achieve it. Probably, some parts of it might not get finished right on time.

I think it is also important to put in the requirement for annual audits of the agencies by a time certain because recognizing that you are going to have an annual audit will mean that each Cabinet Department and each agency head will know that they have got to get these systems fixed up and in place for that annual audit.

And one of the things I have learned over the last 35 years is the audit requirement drives the systems improvements. I used to be more of the opinion that it would be better to get the systems fixed up and then do the audit.

But I am convinced that the better way to do it is to put a date certain as to when you are going to start doing these audits. That is when they know that they have got to get their systems in place. You drive it with that kind of a timeframe.

Chairman GLENN. You have given us a lot of things here this morning—long supply, IRS, Medicare, pension guarantee, student loans, Ex-Im, CCC, FMS, a whole host of things here this morning, and then we have some of the other specific funds.

If you were to prioritize those programs most suitable or appropriate for financial statements, which would you recommend, revolving funds, trust funds, credit programs? Which of those would you start out with first?

Mr. BOWSHER. I would start off with a requirement for the 20 largest agencies in the Federal Government, the major funds, and then the major insurance and credit programs. I would go after all of them and ask that each of them get their financial house in order, you might say.

Chairman GLENN. What would be the impact, or would it be good or bad, if we went to a 2-year budgeting process, which was voted out of this Committee just the day before we went out of session, as a matter of fact, for the second year in a row, that we go to 2-year budgeting?

Now, you are recommending annual financial statements, independent audits of the statements. Considering the condition of the agency accounting systems, could an auditor conduct an audit of the financial statements using those systems? Would it be on a 1-year basis, a 2-year basis? What do you see as working best?

Mr. BOWSHER. I think it best, in this computer age, to do it on an annual basis because computer programs can get changed. It is much better to have the audit on an annual basis than on an every-2-year basis. But I do see some advantages to the biennial budgeting because I think it would give the Congress more time for oversight.

Chairman GLENN. Yes.

Mr. BOWSHER. And I truly believe that you are never going to get on top of these problems unless Congress and the individual cognizant committees hold proper oversight hearings as to what is happening in these agencies, and is progress being made on some of these problems.

Chairman GLENN. You recommend not only annual financial statements, but independent audits of the statements. Now, by independent audits, do you mean your audits or outside audits, or what is independent?

Mr. BOWSHER. The audits could be done by one of three groups. I think we should do a certain portion every year. I think the IGs should do a certain number every year, and I think some agencies could contract with the major CPA firms to do some.

This is exactly what has happened in State and local government. Maryland decided to go for a CPA audit. California went for the State auditor to do their audit. We have a mixture, and that is quite okay because I think all three groups are capable of doing these audits, and it probably would make some sense not only to have all three involved, but to have some kind of a rotation schedule, which I think my office could work out.

I would be more than anxious and willing to share that with this Committee and the cognizant committee over in the House as an annual audit plan. In other words, this is what is going to get audited, this is who is going to do it, this is when we would hope the audit reports would be completed. That type of an audit would make a lot of sense.

Chairman GLENN. I come back to what I asked earlier here. It is going to take a substantial monetary investment to acquire these financial systems. Do you have any ballpark figure? Is this going to be many billions of dollars to put this whole system into effect? Is it going to be millions? Are we talking about $500 million, $10 million, $20 billion? Do you have any ballpark figure of what is going to be required?

Mr. BOWSHER. No. As I said earlier, Mr. Chairman, not until you get the overall architect's plan and find out what is needed in each department. Also, that gets right to the issue of do you do some centralizing of these systems. In other words, can you do more centers like we have down in New Orleans?

Once you have that overall plan, you could figure out the cost, and you could make a good cost/benefit analysis as to what are you going to get out of this. I think that you could be looking at some of these areas, like the receivables at IRS and the inventories, and say if we could get these things in better control and reduced we will have a pay-off from these kinds of improvements.

Mr. STEINHOFF. Presently, we are spending quite a bit of money without a plan. Like right now, we have systems projects ongoing that are estimated to cost in excess of $2 billion, and we have spent billions of dollars in the past on failed efforts where we have gotten nothing at the end.

Mr. BOWSHER. Yes.

Mr. STEINHOFF. So you have to have a structure in place in the plan.

Mr. BOWSHER. I am glad Jeff brought that point out because every year now we are spending well over $1 billion, and I guess the current estimate is in excess of $2 billion, on systems improvements. It is a real mixed bag of what we are getting out of the current expenditure on these systems. We don't have any architectural plan that pulls it all together.

Chairman **Glenn**. Your report indicates that you feel a key factor in strong internal controls is the confidence and motivation of the Federal workforce, and you rightly point out the need to attract and motivate and retain committed people at all levels.

Now, we have just gone through a drill here on pay reform that is going to have some impact. What is you view of these recent pay changes?

Mr. **Bowsher**. I think they are very good. The Government was having a very difficult time attracting first-rate people in some of these areas recently because of the pay limitations. The improvements that were just voted on by Congress should help a great deal, and I applaud the legislative action here.

I do believe that the quality of the people is essential. If we don't have good people working in these accounting and auditing and systems areas, we won't get the job done.

Chairman **Glenn**. I have advocated for a long time delinking this artificial connection between Congress and the Executive Branch of Government and other branches of Government on what the pay scales could be. I think we have to have adequate pay, and if Congress is incapable of dealing with this, I think we at least should have guts enough to deal with the other problems of Government to get good people.

The problem in the public perception and what comes up in public ridicule by the organized write-in and phone-in campaigns that are put on every time we have some pay consideration is they say, well, you shouldn't raise the pay of anybody—the Congress, civil service, judicial, yours, anybody else's pay—until there is better performance in Government.

Yet, you are on the horns of a dilemma. You don't get better people in Government to administer a $1 trillion budget. So I don't know what the—we have sort of got the chicken and the egg there as to which comes first, but I know it hasn't been working well. I know that, and so I am glad we at least have taken some small steps here to try and correct that.

Mr. **Bowsher**. You know, the other day I was having conversations with C. Austin Fitts over at HUD, who is the very, very capable Assistant Secretary of Housing that Jack Kemp and the President have brought in. She was pointing out that she was a partner of one of the major investment banking firms on Wall Street and she says she is just appalled at the magnitude of the issues that the top people in the Government have to handle.

If you don't have qualified people, you are taking a risk. This is a problem that we have slid into in the last 10 or 20 years. You know, in the Depression, people would come to work for the Government because it was a job, and when I served at the Pentagon in the late 1960s, there were a lot of those people still there. They had worked 30 and 40 years with the Federal Government, never got rich, were very happy to have had a steady job for 30 or 40 years.

Once that generation left, though, we had a tendency to not have the pay systems or the personnel practices that attracted the top young people into Government. We have still got a few dedicated people who are willing to come in, but not in the numbers that we need.

The Government has got to be willing to pay adequate salaries if it is going to run these large programs, whether it be housing programs or defense programs or transportation programs. They are of huge magnitude compared to the private sector and they need top people.

Chairman **GLENN**. Your testimony today suggests that we do have massive and growing problems with financial management, and that they can only be dealt with by additional investment in Government, and this will mean new, expensive equipment, hiring maybe even more people, certainly better people. That may mean pay problems; that we have to go through appropriate reorganization, including the creation of CFOs in every agency and at the highest level, and that will be at some expense, obviously.

It seems to me almost an inescapable conclusion that the drive over the past decade or so to shrink the size of Government and to cut things down while we didn't really cut down the functions of Government necessarily—we transferred some of them; we turned over more functions to the private sector.

But I guess I would ask, do you think this has had perverse effect in increasing waste, fraud and abuse instead of curing it?

Mr. **BOWSHER**. Yes, I do. I believe that one of the problems is that we had no plans to achieve the cutback and not lessen our oversight or our control. I think the Social Security Administration is a good example. We have reduced that by thousands of people, but we have never had a good plan over there on improving the systems, which you can do with modern technology.

You can get personnel savings, but if you just lop off the people and don't have the plan on how to improve the operation, you take a tremendous risk. I think that is what we did in recent years.

Chairman **GLENN**. Well, the problem is going to be how do we educate the American people that Government needs more investment in this area if we are going to get control over a $1 trillion budget. I think a lot of people think a trillion is just one step above billions, but if you go back to your grade school arithmetic, each trillion is a thousand billions.

Mr. **BOWSHER**. The sums are tremendous. This year, when you look at what happened in the S&L crisis and look at the HUD situation and things like that, if we had had proper systems, if we had had the adequate financial reporting, if we had had the right number of auditors to go out and check on this, we would have saved billions of dollars. We have been penny-wise and really pound-folish.

Chairman **GLENN**. When you deregulate, you do not cut back the requirement for oversight; you increase it.

Mr. **BOWSHER**. You increase it. That is exactly right, Mr. Chairman, and you should get the people in now that can do that role. Whereas you used to have people that maybe operated the program, you have got to get some people in now that can do the oversight and the monitoring role. If you don't do that, you are at risk of losing vast sums of money very quickly.

Chairman **GLENN**. Well, I hope the administration, in submitting the budget for next year, submits a budget that takes all this into account and asks for the budget funding to do the job that has to be done. I send a message to them this morning. We are going to be happy to work with them, as I know you will be, too, to make sure that gets taken care of.

Does any staff have any questions representing the other Senators here this morning you wish to ask? Anybody else?

[No response.]

Chairman GLENN. Do you have any other comment you want to make before we end?

Mr. BOWSHER. No, Mr. Chairman, except that I would be very pleased to work with you and the Committee here on any legislation that you are planning, because it is this Committee that really passed major and significant legislation for the State and local governments when you passed the single audit legislation.

Chairman GLENN. Right.

Mr. BOWSHER. And I think we can do just as well for the Federal Government, and I would like to work with you on that.

Chairman GLENN. We will work as closely together as we can possibly work. I welcome that opportunity to work with you on this. You have a lot of experience, you and your people.

Mr. Wurtz, Mr. Steinhoff, do you have any statement you wanted to make?

Mr. STEINHOFF. None.

Chairman GLENN. I think it has been excellent. We have covered some interesting ground here this morning, and you have laid out sort of plan here for what your investigations are looking into with the Air Force and the other things you have mentioned here this morning. And as quickly as those become available, or drafts, or whenever you can cut us in on whatever you are finding out, we welcome that so we can do a better job of our oversight here.

This Committee plans to be far more active in the oversight area than we have been in the past. One of the problems with this Committee is that our mandate is so wide, we have narrowed down some of the things that we are charged with doing.

Efficiencies of Government, organization of Government clear across the whole span of Government—those two things are enormous, and you have to channel some of this down. We have that kind of a broad mandate, and there is nothing more important than that we concentrate on this financial management area and trying to get control of it. That is one thing that goes across the full length and breadth of Government, and we look forward to working with you on it.

Thank you all very much for being here this morning. The Committee will stand in recess subject to the call of the Chair.

[Whereupon, at 11:13 a.m., the Committee was adjourned.]

# APPENDIX

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
10:00 a.m.
Wednesday
November 29,
1989

# Federal Internal Control and Financial Management Systems Remain Weak and Obsolete

Statement of
Charles A. Bowsher
Comptroller General of the United States

Before the
Committee on Governmental Affairs
United States Senate

Mr. Chairman and Members of the Committee:

I am pleased to be here today to provide GAO's perspective on the condition of internal control and financial management systems in the federal government.

In January of this year, I brought to this Committee the message that the government faces major problems that are growing and that will not be easily or quickly resolved. At that time, I discussed the seriousness of the budget deficit and problems in key government operations such as the nuclear weapons complex and the Internal Revenue Service (IRS).

Unfortunately, my assessment of almost one year ago still holds true. The seemingly never ending disclosures of fraud, waste, abuse, and mismanagement in federal programs continue to paint the picture of a government unable to manage its programs, protect its assets, or provide taxpayers with the effective and economical services they expect and deserve. One has only to pick up the newspaper to read about scandals in Defense procurement activities or the debacle at the Department of Housing and Urban Development (HUD) which have cost us billions of dollars and further undermine confidence in government. As demonstrated in the report we are releasing today, entitled Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses (GAO/AFMD-90-10), the problems that exist are not limited to a few agencies or a few programs; rather, all of the major agencies have serious problems.

## MANY PROBLEMS ARE KNOWN BUT REMAIN UNCORRECTED

Agencies essentially know what their major problems and vulnerabilities are. Unfortunately, time and time again we find situations where agencies and auditors have identified problems, yet the corrective actions taken, if any, are ineffective, and the problems remain uncorrected for years. The following examples illustrate this point.

-- Federal credit assistance and insurance programs have increased from $400 billion to over $5 trillion in the past 2 decades. As a result of deficiencies in financial management systems and inconsistencies in the application of accounting principles by agencies administering these programs, many agencies have understated their current losses. The recognized losses from these programs over the past several years total in the $200 billion range. These losses have already significantly impacted the federal deficit. We anticipate additional tens of billions of dollars in future losses in other programs.

-- Federal agencies are spending billions of dollars developing and acquiring automated systems and are experiencing massive problems in the process. Design flaws, misjudgments in requirements, and poor program management caused the Navy to halt installation of a new automated management information system after spending an estimated $230 million over 9 years to develop the system. Unfortunately, the Navy's experience is not uncommon.

-- The basic structures of many present federal financial management systems were designed during the World War II time period. Financial reports resulting from these systems provide a flood of data but little reliable operational and cost information that is essential to monitor programs, anticipate overruns, and provide bases for program and budget planning.

-- HUD's financial management and accounting systems cannot provide basic accountability and control over program funds, a problem that has plagued the Department for many years and that is, unfortunately, not confined to HUD. Our recent financial audit of the Federal Housing Administration (FHA) showed that while FHA's financial reports showed losses of $858 million for fiscal year 1988, in fact, the losses were $4.2 billion, or almost five times greater than management's best information showed them to be.

-- The lack of accurate receivables information has inhibited IRS' efforts to collect its receivables, which have grown to more than $50 billion.

## FINANCIAL INTEGRITY ACT EFFORTS HAVE NOT ACHIEVED THEIR INTENDED RESULTS

What must be done to eliminate these problems or at least reduce their impact? Sound internal control and financial management systems are essential to the effective and economical operation and management of any program. They are absolutely critical in times of high budget deficits, ever increasing debt ceilings, and a continuing erosion of the public's confidence in the government's ability to manage its programs. In 1982, the Congress passed the Federal Managers' Financial Integrity Act in an attempt to strengthen agency internal control and financial management systems by requiring agency self-evaluations of those systems and annual reports to the President and the Congress on the condition of the systems. While agencies have identified and reported correcting many system weaknesses, these efforts have clearly not produced the results intended by the Congress when it passed the act.

It is evident, based on examinations of the system problems that agencies have reported in their annual Financial Integrity Act reports and that GAO and federal audit organizations have identified in their audit reports, that

- -- the government does not currently have the internal control and accounting systems necessary to effectively operate many of its programs and safeguard its assets;
- -- many weaknesses are long-standing and have resulted in billions of dollars of losses and wasteful spending;
- -- major government scandals and system breakdowns serve to reinforce the public's perception that the federal government is poorly managed, with little or no control over its activities; and
- -- top-level officials must provide leadership if this situation is to ever change.

## ACTIONS NEEDED TO STRENGTHEN CONTROLS AND ACCOUNTING SYSTEMS

I believe that intensified oversight by the Congress and by the Office of Management and Budget (OMB) are needed to help ensure more effective internal controls and financial management systems in government programs. In addition, the agencies can take actions to strengthen their Financial Integrity Act programs and increase the usefulness of the annual reports they issue.

In July 1989, the Internal Control Interagency Coordination Council, an organization composed of representatives from all the major agencies, OMB, and GAO issued a report that recommended several actions to improve federal implementation of the Financial Integrity Act. These include

-- linking the Financial Integrity Act internal control review and reporting process to the budget;

-- providing for and promoting senior management involvement in the internal control process;

-- identifying, in annual reports, agency actions to correct weaknesses; and

-- validating that corrective actions have been accomplished and were effective.

I endorse these recommendations and urge OMB to take prompt action to ensure that agencies implement them. OMB has increased its attention to major problems within agencies and has taken actions to ensure that these problems receive high-level priority attention within the agencies. It has identified high risk areas in each of the 16 largest federal agencies and plans oversight of agency actions to correct problems in these areas.

While I am encouraged by the steps it has taken, OMB is only a part of the solution, and my optimism is somewhat guarded. Mr. Chairman, I would like to read some excerpts from an article entitled "The Stench at FHA" to illustrate a point.

> "FHA has approved marginal or hopeless projects, let promoters milk them . . . and then abandon them. And while FHA has sat dumbly by, other promoters have gone from city to city defaulting on project after project. It has permitted still others to default on loans but continue to collect rents for up to five years. . . . In the last 30 months, the GAO has submitted to Congress 11 reports indicting FHA for derelictions ranging from misrepresentations of its income to slovenly neglect of its own foreclosed property."

That quotation is similar to many others written over the past several months. However, there is one significant difference. It is taken from an April 1966 Reader's Digest article. Unless something more is done to correct agency internal control and financial management system weaknesses, major losses of federal funds and the collateral incidents of fraud and abuse will continue. My concern is that 20 years from now, there may be another Comptroller General giving testimony on the government's failure to manage its programs and resources.

The Financial Integrity Act report we are releasing today recommends several actions that should result in stronger internal control and financial management systems throughout the government.

First, we believe that the Congress can significantly contribute to effective corrective action through its oversight role. Through the authorizing, appropriations, and oversight committees, it should hold annual hearings using Financial Integrity Act reports, plans for corrective actions, and audited agency financial statements as the focal point in the process of reviewing agency actions to correct internal control and accounting system weaknesses. Such hearings could help assure the Congress that corrective measures are actually implemented. Unfortunately, the Congress increasingly finds that it has too little time for oversight activities because budgeting has become an endless, repetitive cycle that takes priority. We have recommended actions to streamline the budget process.[1]

Next, the widespread occurrence and significant dollar and programmatic impact of federal accounting system weaknesses, in particular, highlight the need for a new approach to federal financial management. I have long been a strong advocate of legislation which would

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[1] Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices (GAO/AFMD-90-1, October 1989).

- -- establish a chief financial officer structure for the federal government, with counterpart chief financial officers in each of the major agencies, and
- -- require the annual preparation and audit of agency financial statements.

Until such legislation is passed, OMB and Treasury, working with the administratively appointed chief financial officers in the federal agencies, should be charged with developing and maintaining long-range plans which tie management systems together, much as an architect's drawings provide a guide to the construction of a building. Such a planning effort would ensure that agencies look more than one year ahead in determining future financial system needs and in coordinating their plans. Besides upgrading out-dated financial management systems, long-range planning would be a catalyst to needed standardization of accounting systems and increased use of shared services among agencies. For example, a number of federal agencies--including GAO--now use the Department of Agriculture's National Finance Center in New Orleans to handle payroll and other accounting needs. Such expanded coordination and sharing could minimize the government's operating costs and increase the comparability of information.

One point needs to be stressed here: it will take a substantial monetary investment to acquire the systems that are needed and to train personnel to operate them. In an era of severe budget restraint, there may be a temptation to take shortcuts to hold down these costs. I strongly believe, however, that new systems will ultimately pay for themselves. The payoff will come not only in terms of better efficiency and prevention of loss from fraud, waste, abuse, and mismanagement, but also in greater confidence in the integrity of government operations and program decisions.

The annual preparation and audit of financial statements will provide the cornerstone to the reforms that we seek. It is fair to say that without the demands imposed by a requirement to prepare accurate financial statements, the underlying financial management systems will be weak. In these situations, the subsystems do not provide information needed to properly manage the agency or protect its funds and other assets from losses of all kinds--including waste, fraud, and abuse. I cannot overstate the deplorable condition of financial management systems in the government. The agencies know how to spend the money you provide, but they now cannot effectively manage its use because they lack the most basic financial management systems. I think that forcing agencies to prepare accurate financial statements will provide a very strong incentive to get their financial management systems in order.

For years, the federal government has insisted that publicly traded companies, as well as state and local governments, submit their financial statements to the scrutiny of an independent audit. The federal government should do no less. Annual audits promote discipline in the recording and processing of data simply because people know that the information is subject to scrutiny. The improved quality of the financial information enables agencies to place greater reliance upon it in making decisions and monitoring implementation of programs. Furthermore, audits undoubtedly result in strengthened internal controls. In the case of FHA, although independent auditors were unable to render an opinion on the fiscal year 1988 financial statements, the audit identified losses about five times greater than those reported by the agency. Instead of having a surplus, the program has a $3 billion deficit.

Implementing the recommendations cited in our report is critical in order to realize the purposes of the Financial Integrity Act, to bring about meaningful financial reform, to enable the government to reestablish accountability for federal programs and assets, and to regain the confidence of the American public.

## GAO IS INTENSIFYING ITS INTERNAL CONTROL AND ACCOUNTING SYSTEM EFFORTS

For our part, I have directed GAO to intensify its efforts to help the Congress and the agencies identify those programs with critical weaknesses in their internal control and financial management systems that are most likely to result in material losses. This program will initially include

-- identifying the major areas we believe to be most vulnerable;

-- focusing, in conjunction with efforts of agency management and the inspectors general, on the root causes of serious long-standing weaknesses to develop approaches to solve the problems;

-- monitoring agency corrective actions and reporting the results to the appropriate congressional committees; and

-- recommending the legislative action necessary to ensure that corrective measures are implemented.

The legislative and executive branches of government must form a partnership, with the common goal of achieving effective and economical federal programs and sound financial management systems.

We cannot merely think in terms of tomorrow, waiting for something to happen. The poor state of internal controls and financial management systems demands that we think and act today.

- - - - -

Mr. Chairman, this concludes my formal statement. I want to thank you and former Committee Chairman Roth for your continuing support of financial management reform legislation, and I will be happy to answer any questions you or members of the Committee may have.

United States General Accounting Office

GAO

Report to the Congress

November 1989

# FINANCIAL INTEGRITY ACT

## Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses

GAO/AFMD-90-10

GAO United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-216946

November 28, 1989

The President of the Senate and the
Speaker of the House of Representatives

The Federal Managers' Financial Integrity Act of 1982 (Pub. L. No. 97-255, 96 Stat. 814) requires ongoing evaluations of the internal control and accounting systems that protect federal programs against fraud, waste, abuse, and mismanagement. It further requires that the heads of federal agencies report annually to the President and the Congress on the condition of these systems and on their actions to correct the weaknesses identified.

This is GAO's fourth governmentwide report on federal efforts to strengthen internal control and accounting systems under the act. It illustrates the types and severity of the internal control and accounting system problems that exist throughout the government and the need for a vigorous program to correct these problems. These problems cost the taxpayer billions of dollars, result in ineffective programs, and paint a picture of federal agencies unable to manage their programs and fully account for their assets. The continuing existence of serious internal control and accounting system weaknesses reinforces the need for intensified actions to strengthen controls across the government and for comprehensive reform of the government's accounting systems.

This report recommends several actions by the Office of Management and Budget and the Congress to improve agency implementation of the act and strengthen the condition of internal control and accounting systems throughout the government. It also discusses how GAO will place greater emphasis on selected high risk areas within the government and develop actions to correct the problems in those areas.

We are sending copies of this report to the Director of the Office of Management and Budget and the heads of federal agencies. We call on them to emphasize the importance of strong internal control and accounting systems and to take steps to improve implementation of the act.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

# Executive Summary

## Purpose

This is the General Accounting Office's (GAO) fourth overall report on the implementation of the Federal Managers' Financial Integrity Act of 1982. It discusses GAO's views on the condition of internal control and accounting systems within the government; the types of systems problems that agencies have faced and continue to face; and their efforts to correct the system weaknesses identified and reduce the occurrence of fraud, waste, abuse, and mismanagement in federal programs. Because of the seriousness and continuing nature of the deficiencies noted in this report and the lack of satisfactory progress in correcting them, this report also contains recommendations to strengthen governmentwide implementation of the act.

## Background

The Congress passed the Financial Integrity Act in an attempt to improve the government's ability to manage its programs. It recognized that strong internal control and accounting systems help ensure proper use of funds and resources, compliance with laws and regulations, and preparation of reliable financial reports for oversight and decision-making.

The act requires the head of each agency to report annually to the President and the Congress on the condition of agency internal control and accounting systems. The report must describe the material internal control weaknesses identified and agency plans for correcting them, and state whether the agency's accounting system conforms to the Comptroller General's accounting principles, standards, and related requirements. The act holds agency managers publicly accountable for correcting deficiencies noted.

## Results in Brief

The most pressing crisis facing the government today is the federal budget deficit and the growing accumulation of debt. The burdens of the government's estimated $139 billion share of the savings and loan crisis cleanup costs, Federal Housing Administration losses of $4.2 billion, and the continuing growth of the $89 billion of uncollected delinquent debts and taxes owed the federal government represent only a few of the difficulties facing the administration and the Congress in their efforts to improve federal programs and stem the tide of red ink. Each of these problems, with its attendant cost to the taxpayer, represents a failure that could have been substantially reduced by a more effective system of internal controls.

While the government's efforts to strengthen its programs and implement the act have evolved over time and agencies have reported achieving some success in identifying and correcting material internal control and accounting system weaknesses, these efforts have clearly not produced the results intended by the Congress when passing the act. Seven years after the Financial Integrity Act became law, it is evident that

- the government does not currently have the internal control and accounting systems necessary to effectively operate many of its programs and safeguard its assets;
- [illegible] of the weaknesses are long-standing and have resulted in billions [illegible]ars of losses and wasteful spending;
- major government scandals and system breakdowns serve to reinforce the public's perception that the federal government is poorly managed, with little or no control over its activities; and
- top-level officials must provide leadership if this situation is to ever change.

## Principal Findings

### Widespread Internal Control and Accounting System Problems Remain

The government continues to be plagued by serious breakdowns in its internal control and accounting systems. Management deficiencies, program abuses, and illegal activities cost the taxpayers billions of dollars and undermine their confidence in the government. This situation is unacceptable under any circumstance, but becomes even more serious in light of overwhelming budget deficits. The scandal at the Department of Housing and Urban Development (HUD), for example, has seriously impacted several of the nation's housing programs and the integrity of government. HUD, however, is not alone. The Director of the Office of Management and Budget (OMB) recently testified before the Senate Committee on Governmental Affairs that "The recently-exposed HUD problems are not unique, not merely peculiar to a particular agency under what some have described as absentee management. . . . There are analogous problems in other agencies."

Other examples of deficiencies in federal programs follow.

- Delinquent debts and taxes continue to grow and are now reported at over $89 billion. The Internal Revenue Service, which has seen its receivables increase to over $50 billion, a threefold increase since 1981, has been plagued by the lack of accurate receivables information which has inhibited its efforts to collect these debts. (See chapter 2.)

- Federal agencies are spending billions of dollars developing and acquiring automated systems and are experiencing massive problems in the process. Design flaws, misjudgments in requirements, and poor program management caused the Navy to halt installation of a new automated management information system after spending an estimated $230 million over 9 years to develop the system. Unfortunately, the Navy's experience is not an exception. (See chapter 2.)
- The Department of Defense has historically had problems managing its spare parts inventories. From 1980 to 1988, the value of unneeded secondary inventory items almost tripled, going from $10 billion to $29 billion. (See chapter 2.)
- The federal government continues to rely on accounting systems that, despite improvement efforts over many years, have serious problems. Existing systems are antiquated; in a general state of disrepair; costly to operate and maintain; and do not produce the complete, timely, and reliable financial data needed to help make policy and management decisions. All but 1 of the 18 agencies GAO reviewed reported material weaknesses in their accounting systems. (See chapter 2.)

## Managers See Mixed Results From Financial Integrity Act Efforts

The Financial Integrity Act has had some results in focusing managers' attention on agency problems. Senior agency executives and the managers responsible for day-to-day operations of programs, in responding to a GAO questionnaire, perceived that internal controls have improved as a result of the act and identified benefits that resulted from the evaluations conducted. This is in sharp contrast to the early years of the act's implementation when managers were largely critical of the process, which they characterized as a paper exercise.

At the same time, federal managers' questionnaire responses identified a number of areas where greater emphasis is needed. Almost one-half of the federal managers responsible for implementing the act had received no training concerning the conduct of risk assessments, internal control evaluations and other functions essential to effective implementation of the act. Also, managers reported that a significant number of agency activities had received one or no evaluation of their control systems since 1982. (See chapter 3.)

## Greater Top-Level Leadership Is Needed

Unless something more is done to correct agency internal control and accounting system weaknesses, major losses of federal funds and the collateral incidents of fraud and abuse will continue. Most of the problems are known and, in many instances, have been known for years, but they remain uncorrected. Timely and effective corrective action has been a problem. Agencies must increase their efforts to correct the weaknesses, ensure proper control and accountability over their programs, and ensure the existence of the efficient and effective federal programs that the American public expects and deserves.

In October 1989, OMB issued to each of the 16 largest agencies a critique of agency reporting under the act, a listing of agency highest risk areas, and a listing of key elements necessary to achieve early identification and correction of problems. OMB's actions respond to GAO's primary concern that major problems must receive high-level priority attention, and they address several of the recommendations made by the Internal Control Interagency Coordination Council in its July 1989 report to the President's Council on Management Improvement. A number of other important recommendations in that report remain to be addressed, including

- linking the Financial Integrity Act internal control review and reporting process to the budget;
- providing for and promoting senior management involvement in the internal control process;
- identifying, in annual reports, agency actions to correct weaknesses; and
- validating that corrective actions have been accomplished and were effective. (See chapter 3 and appendix V.)

## Recommendations

GAO, which participated in the Council study, strongly endorses the recommendations of the Internal Control Interagency Coordination Council and recommends that OMB take prompt action to ensure that agencies implement them.

GAO further recommends that OMB increase its oversight of agency internal control and accounting system evaluation, reporting, and corrective action processes to ensure that the agencies are effectively implementing the act.

GAO believes that the Congress can significantly contribute to effective corrective action through its oversight role. GAO recommends that the

Congress, through its authorizing, appropriations, and oversight committees, hold annual hearings using Financial Integrity Act reports, plans for corrective actions, and agency financial statements as the focal point in the process of reviewing agency actions to correct internal control and accounting system weaknesses. Such annual hearings could help assure the Congress that corrective measures are actually implemented.

The widespread occurrence and significant dollar and programmatic impact of the weaknesses in federal accounting systems, in particular, highlights the need for a new approach to federal financial management. GAO urges the Congress to enact legislation which would

- establish a Chief Financial Officer of the United States with responsibility for, among other things, developing and implementing a long-range financial management improvement plan for the government;
- set up chief financial officers in each major agency; and
- require the annual preparation and audit of agency financial statements.

GAO believes the above recommendations are critical for meaningful financial reform to take place, and, if implemented, will help bring about the purpose of the Congress when it passed the Financial Integrity Act.

For its part, GAO is intensifying its efforts to help the Congress and the agencies identify those programs with critical weaknesses in their internal control and accounting systems that are most likely to result in material losses. This program will initially include

- identifying the major areas GAO believes to be most vulnerable;
- focusing, in conjunction with efforts of agency management and the inspectors general, on the root causes of serious long-standing weaknesses to develop approaches to solve the problems;
- monitoring agency corrective actions and reporting the results to the appropriate congressional committees; and
- recommending the legislative action necessary to ensure that corrective measures are implemented.

## Agency Comments

This report primarily summarizes problems and actions previously identified in agency Financial Integrity Act or GAO reports. Therefore, GAO did not obtain official comments from the 18 agencies included in this report. GAO obtained comments from OMB officials, and they agreed with the report's thrust and recommendations to OMB.

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## Abbreviations

| | |
|---|---|
| ADP | automated data processing |
| AICR | alternative internal control review |
| CFO | Chief Financial Officer |
| CHAMPVA | Civilian Health and Medical Program (Veterans Administration) |
| DOD | Department of Defense |
| DOE | Department of Energy |
| DSAA | Defense Security Assistance Agency |
| FAA | Federal Aviation Administration |
| GAO | General Accounting Office |
| GSA | General Services Administration |
| HCFA | Health Care Financing Administration |
| HHS | Department of Health and Human Services |
| HUD | Department of Housing and Urban Development |
| ICR | internal control review |
| IG | inspector general |
| IRS | Internal Revenue Service |
| NASA | National Aeronautics and Space Administration |
| OMB | Office of Management and Budget |
| OPM | Office of Personnel Management |
| PCIE | President's Council on Integrity and Efficiency |
| PCMI | President's Council on Management Improvement |
| VA | Department of Veterans Affairs |

Chapter 1

# Introduction

In 1982, the Congress passed the Federal Managers' Financial Integrity Act (Pub. L. No. 97-255, 96 Stat. 814 (September 8, 1982)) to strengthen internal control[1] and accounting systems throughout the federal government and reduce fraud, waste, abuse, and misappropriation of federal funds. (See appendix I.) At that time, audits of government programs and media reports identified an almost never ending trail of serious problems in areas cutting across all agencies and programs. That situation has changed little since 1982. Adding to these problems is the need to manage the government's rising debt of $2.8 trillion. Together, the deficiencies identified in federal programs and the massive debt continue to paint a picture of federal agencies that are unable to manage their programs and properly control and fully account for their resources.

This, our fourth report on the efforts of the 18 largest federal departments and agencies[2] to implement the act, illustrates the seriousness of the internal control and accounting system problems encountered in recent years and the need for a vigorous program to correct these problems. It also provides the perspectives of various levels of agency management on the effect of the act and the benefits and problems resulting from their implementation of it.

## Requirements of the Act

The act is a brief, concise, straightforward document. Section 2 of the act requires that agency systems of internal control comply with internal control standards prescribed by the Comptroller General and provide reasonable assurance that

- obligations and costs are in compliance with applicable laws;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The act's application is very broad and covers the programs, activities, operations, and functions of federal agencies. The act addresses the entire range of policies and procedures (e.g., internal controls) that management employs to perform its mission efficiently and effectively and to provide a full accountability to the taxpayer. In passing it, the Congress took a major step forward by requiring that the head of each executive agency report annually, to the President and the Congress, on the status of agency internal control systems, and by holding managers publicly accountable for correcting weaknesses in those systems. The act further required

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[1] For purposes of the act, the terms internal controls, internal accounting and administrative controls, and management controls are synonymous.

[2] The 18 agencies account for about 95 percent of the federal government's expenditures.

- the Comptroller General to establish internal control standards with which executive agency systems of internal control shall comply, and
- the Office of Management and Budget (OMB) to prepare guidelines for agency use in developing the internal control review and evaluation programs needed to support the agency head's annual report.

Section 4 of the act requires that the agency head's annual Financial Integrity Act report include a separate report on whether the agency's accounting system conforms to the Comptroller General's accounting principles, standards, and related requirements.[1] Here also, the act's goal is for agencies to recognize their accounting system problems and to correct them so that the government has first-rate systems.

## Brief History of the Governmentwide Efforts to Implement the Act

Executive agencies faced a major challenge in implementing the act. The first annual Financial Integrity Act reports were due by December 31, 1983. Between October 1982 and December 31, 1983, each agency had to develop and implement an agencywide internal control evaluation and reporting process that provided the information needed to support the first agency head report to the President and the Congress.

Before developing their implementation procedures and beginning the required evaluations, agencies needed some central, governmentwide direction on how to implement the act and standards against which to evaluate their control systems. OMB provided the implementation guidance in December 1982 when it issued its "Internal Control Guidelines." This document provided agency management with guidance on the development of plans for evaluating, correcting, and reporting on its internal control systems.

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[1] GAO's Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, Title 2 prescribes the overall accounting principles and standards, while Titles 4, 5, 6, and 7 specify requirements governing claims, transportation, pay, leave, and allowances, and fiscal procedures, respectively. Agency accounting systems must also comply with the Comptroller General's internal control standards as well as requirements set forth in the Treasury Financial Manual and OMB circulars.

The General Accounting Office (GAO) provided the second form of guidance when it issued "Standards for Internal Controls in the Federal Government" in 1983. Like the act, these internal control standards apply to program and general management as well as the traditional internal accounting and administrative control areas.

In addition, each year since passage of the act, GAO, OMB, and the offices of inspector general have provided assistance to aid federal agencies in understanding internal controls, developing evaluation and reporting systems, and preparing the annual reports.

## Previous GAO Financial Integrity Act Reports and Testimony

We have monitored federal efforts to implement the act since 1983. Our first overall report[1] characterized the initial agency efforts to assess and report on the status of their internal control systems as a learning experience. The need existed for more effective identification and correction of material internal control weaknesses and a more accurate description of the status of the internal control systems. We recommended that OMB improve its guidance to agencies on evaluating and reporting on internal control systems.

Our second governmentwide report[2] summarized many of the internal control and accounting system problems facing the government and noted that the internal control system assessment activities often did not result in reliable and useful information to agency managers. Agency personnel widely criticized the assessment processes as paperwork exercises. The report reiterated the recommendations contained in our first report.

In June 1986 testimony before the House Committee on Government Operations, the Comptroller General reemphasized the seriousness of the internal control weaknesses facing the government and the importance of correcting those problems in a more timely manner.[6] Specifically, he cited a need for

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[1] Implementation of the Federal Managers' Financial Integrity Act: First Year (GAO/OCG-84-3, August 24, 1984).

[2] Financial Integrity Act: The Government Faces Serious Internal Control and Accounting Systems Problems (GAO/AFMD-86-14, December 23, 1985).

- managers to focus on risks when identifying systems needing improvement rather than waiting for major breakdowns to occur before taking action,
- strong central leadership and coordination of financial management improvements,
- a commitment of resources for such improvements, and
- continued congressional support.

Our third governmentwide report[7] provided an overall perspective on the progress agencies had made since the act's passage, the internal control and accounting systems problems that remained, and identified some efforts under way to correct those problems. We pointed out that long-standing problems needed sustained attention from agency management and continued to plague federal programs.

We also discussed the poor condition of internal controls over federal programs and the governmentwide impact this has had on efficient and effective program operations in our recent transition series report on financial management.[8] The report concluded that the administration and the Congress need to clearly articulate priority and support for internal control improvement initiatives. In addition, we called on the new administration to

- give priority to correcting known, long-standing internal control problems and
- hold leadership at those agencies with internal control problems accountable for improving internal controls.

In addition, the report discussed

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[6] "The Government Faces Serious Internal Control and Accounting Systems Problems," Statement of Charles A. Bowsher, Comptroller General of the United States, before the House Government Operations Committee, delivered on June 4, 1986.

[7] Financial Integrity Act: Continuing Efforts Needed to Improve Internal Control and Accounting Systems (GAO/AFMD-88-10, December 30, 1987).

[8] Financial Management Issues (GAO/OCG-89-7TR, November 1988).

- the need for agency inspectors general to emphasize the review of internal control systems and make managers fully aware of the internal control implications of audit findings and
- the need for a major accounting system reform initiative establishing a chief financial officer structure in the government and a long-range, governmentwide financial management improvement plan.

## Objective, Scope, and Methodology

The objective of this review is to discuss the overall condition of internal control and accounting systems within the federal government and to recommend actions to strengthen and accelerate implementation of the act. To accomplish this objective, we focused on four key questions. First, what have the Financial Integrity Act activities of the 18 largest federal agencies (see appendix II) accomplished since passage of the act? Second, do any problems exist that reflect areas needing more attention in order to make agency implementation of the act more effective? Third, what is the current condition of internal controls over federal programs and activities? Finally, what can the federal government do to further strengthen internal controls and better meet the objectives of the act?

To answer these questions, we

- reviewed the information contained in the annual agency Financial Integrity Act reports and in the three governmentwide GAO Financial Integrity Act reports that discussed the progress agencies had made since the act's passage, the internal control and accounting system problems remaining, and efforts under way to correct the problems;
- obtained, through questionnaires and interviews, perceptions and historical information concerning the act from several levels of agency management (see appendix III for a description of the data collection methodologies used);
- discussed agency implementation and the effects of the act with the inspector general or chief audit official in each agency included in our review;
- reviewed GAO audit and other audit organization reports that identified internal control and accounting systems weaknesses in agency programs, activities, organizations, and functions; and
- reviewed GAO testimony and speeches, OMB reports, and news media articles that discussed internal control and accounting system weaknesses and corrective actions.

We performed our work from January 1988 through September 1989 in accordance with generally accepted government auditing standards. We obtained comments from OMB, which oversees federal agency implementation of the act, and it concurred with the report's contents. We did not obtain comments from the 18 agencies included in our review because this report addresses the governmentwide effort to strengthen internal control systems. For illustrative purposes, the report discusses previously issued GAO, inspector general, and agency reports which address agency-specific problems and make recommendations for corrections. This fourth governmentwide report also presents a compilation of agency managers' perceptions of the act and of the condition of internal controls within their programs and activities.

In preparing this report, we did not independently evaluate the adequacy of agency internal control and accounting systems and agency reported corrective actions. Instead, we analyzed the agencies' reports under the act and GAO and inspectors general reports which addressed internal control problems and agency corrective actions.

Federal agencies have 7 years of experience under the act in which to evaluate and correct their internal control system problems. In chapter 2, we discuss the seriousness of the problems agencies are still experiencing and the need for effective initiatives to correct these problems. In chapter 3, we discuss the perceptions of agency managers and audit officials about the impact that the act has had on program efficiency and effectiveness and some problems encountered in implementing the act. We also discuss agency and OMB efforts to strengthen implementation of the act and to better focus on needed corrective actions. Chapter 4 contains recommendations for actions needed by OMB and the Congress to strengthen internal control and accounting systems in federal agency programs and highlights GAO's program for addressing high risk areas in agencies.

Chapter 2

# Internal Controls: Agency Experiences and Future Directions

Since passage of the Financial Integrity Act in 1982, federal agencies have conducted tens of thousands of assessments and other evaluations of their internal control and accounting systems, developed and implemented actions to correct weaknesses identified, and reported the results to the President and the Congress. According to OMB statistics, through 1988, the 18 agencies included in our review identified about 2,200 material weaknesses in their internal control systems.

Despite the reported correction of 1,800 material weaknesses, the condition of controls throughout the government remains poor. Agencies do not currently have the internal controls necessary to effectively manage their programs and safeguard their assets. Serious weaknesses exist in each of the 18 agencies included in our review. There is a seemingly never ending and costly trail of mismanagement, abuse, and illegal acts involving federal programs. One need only look at the Department of Housing and Urban Development to find an agency rocked by disclosures of widespread instances of mismanagement, theft, favoritism, and influence peddling involving billions of taxpayer dollars. Results of these disclosures have been the Secretary's suspension of three agency housing programs and a discrediting of government.

In this chapter, we will look at the types of internal control and accounting system problems that agencies must resolve if they are to make the goals of the Financial Integrity Act a reality. We highlight agency and governmentwide initiatives to correct these weaknesses, and discuss actions needed to strengthen internal control and accounting systems over federal programs.

## Control Weaknesses Span a Broad Range of Activities

Agency self-evaluations of internal control and accounting systems and GAO, IG, and other audit organization reports have identified material internal control system weaknesses in agency programs each year since implementation of the act. These weaknesses cover a broad range of functions and cut across all phases of the government's operations. They can have a serious impact on the ability of the programs involved to meet their intended objectives and collectively put the government at high risk.

Federal programs operate in an ever changing environment. Implementation of new programs, changes in existing program objectives, personnel turnover, and use of new technologies can all affect the condition of controls over government programs. Therefore, to some extent, the continued identification of material internal control and accounting system weaknesses is not unexpected. The Financial Integrity Act called for ongoing agency self-evaluations of their internal control and accounting systems to help ensure that the weaknesses that arise over time are identified and corrected.

Table 2.1 summarizes the number of the 18 agencies included in our review that have reported uncorrected material weaknesses in each category as of the end of each of the first 6 years of the act. As in our three previous governmentwide Financial Integrity Act reports, we separated these weaknesses into eight broad categories which depict a wide range of activities experiencing problems.[1]

**Table 2.1: Comparison of the Number of Agencies Reporting Material Weaknesses by Category**

| | Number of Agencies | | | | | |
|---|---|---|---|---|---|---|
| **Category** | **1983** | **1984** | **1985** | **1986** | **1987** | **1988** |
| Procurement | 14 | 14 | 13 | 13 | 11 | 10 |
| Credit management | 13 | 13 | 14 | 11 | 8 | 7 |
| Eligibility and entitlement determinations | 9 | 10 | 9 | 8 | 5 | 4 |
| Cash management | 12 | 12 | 12 | 13 | 6 | 8 |
| Automated data processing | 10 | 14 | 17 | 17 | 13 | 13 |
| Property management | 14 | 15 | 16 | 16 | 9 | 10 |
| Financial management and accounting systems | 17 | 17 | 17 | 17 | 15 | 17[a] |
| Personnel and organizational management | 10 | 12 | 11 | 16 | 12 | 10 |

[a] Although NASA's 1988 Financial Integrity Act report identified no accounting system nonconformances, OMB recently identified financial systems as a high risk area within NASA.

These numbers do not tell a complete story, however, because they do not provide insight into the seriousness of individual weaknesses reported. In the remainder of this chapter, we will complete the picture by discussing material weaknesses in each of the eight categories.

## Procurement

The acquisition of goods and services involves substantial federal outlays. The government spends about $200 billion annually on 22 million contracts for goods and services. It is important, therefore, to have strong internal controls over agency procurement processes in order to protect this large investment and to ensure that only needed goods and services are ordered, prices paid are reasonable, and goods delivered meet quality standards.

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[1] We renamed the category "Grants, Loans and Debt Collection Management" to "Credit Management" to be compatible with discussions in the administration's fiscal year 1990 Management of the United States Government report.

Procurement problems cost the government billions of dollars annually, but the cost is not restricted to dollars. Faulty procurement practices and weak controls have resulted in the acceptance of defective or below specification parts, cost overruns, and increased risk of injury and loss of life.

The Department of Defense (DOD) procurement system is probably the largest and most complex in the world and managing it has always been formidable. In the area of the implementation of strong internal control systems, the Department has tended to be reactive rather than proactive. Common problems include cost growth, extremely long acquisition time, and program stretchouts resulting in inefficient production rates. Together with the disclosures resulting from procurement scandal investigations, these problems raise serious questions about DOD's ability to effectively manage its acquisition programs. Examples of procurement weaknesses within DOD follow.

- The Air Force contracted for the production of a new strategic bomber, the B-1B. A fast paced production schedule, driven by the need to meet an early initial operational capability date, conflicted with the orderly completion of B-1B development and flight testing. After spending over $30 billion, however, the B-1Bs do not work as planned. (See GAO/NSIAD-88-13 and GAO/T-OCG-89-27.)
- In July 1988 testimony before the Senate Armed Services Committee, we cited a case in which the Commander of the Naval Security and Investigative Command, in October 1987, reported instances of procurement fraud, such as conflict of interest and bribery. He also indicated that several of the Command's ongoing and recently closed investigations involved high ranking Naval officers and high level Navy Department civilians. The Navy official indicated that emphasis must continue to be given to compliance with existing systems and assigning personnel responsibility for proper operation of those systems. (See GAO/T-NSIAD-88-38.)

The Department of Defense is not the only agency experiencing procurement problems. The General Services Administration (GSA), which plays a major leadership role in implementing procurement policy within the federal government, has also experienced serious internal control weaknesses in the procurement area. The new federal telecommunications system, FTS 2000, is an example. This system is designed to make available a comprehensive range of advanced voice, data, and related telecommunications services. In an August 1987 report, we noted that GSA's overall strategy for identifying and meeting the governmentwide telecommunications requirements was based on inadequate knowledge of the range of government needs and that GSA gave insufficient consideration to potentially attractive alternative technical strategies. Since GSA did not conduct a complete analysis of the range of alternatives for satisfying federal telecommunication requirements, questions arose as to whether FTS 2000 was optimal either technically, economically, or contractually. (See GAO/IMTEC-89-6, GAO/IMTEC-87-42, and GAO/IMTEC-88-24.)

The President's fiscal year 1989 and 1990 Management of the United States Government reports (Management Report) and a July 1989 Secretary of Defense plan discuss initiatives to address weaknesses in procurement practices. Many of the reform activities are based on recommendations of the Blue Ribbon Commission on Defense Management (the Packard Commission) and relate to underlying procurement principles and policies as well as the procurement processes themselves. Some of these initiatives include: (1) consolidating and simplifying the statutory and regulatory base of federal procurement, (2) streamlining the development of governmentwide procurement regulations, (3) rescinding unnecessary regulations, (4) increasing competition in the award of government contracts, (5) applying commercial techniques to small purchases, (6) improving procurement data collection, (7) improving the competence and calibre of the procurement work force, and (8) restoring the authority of contracting officers.

If the reform activities are implemented and result in improved controls over the procurement process, federal agencies can better ensure that what we buy meets our needs and that prices paid are reasonable without large cost overruns or program stretchouts. However, these problems are long-standing and will require a sustained commitment to convert plans and initiatives to solid actions that work to correct the problems.

## Credit Management

The management of federal credit programs and collection of amounts owed the government by those participating in these programs is an ever growing problem. Taxpayers, loan recipients, users of federal land and resources, and others owe the government billions of dollars. Federal loan programs often extend credit on easier terms and conditions than are available in the private sector in order to meet legislated policy objectives and accomplish a variety of social and economic goals. According to the President's fiscal year 1990 Management Report, total 1988 federal receivables were $316 billion, and about 28 percent, or $89 billion, was classified as delinquent. Overdue taxes accounted for about 64 percent of the delinquencies.

During the 1970s and 1980s, GAO emphasized the need for proper accounting for receivables and greater use of commercial practices in an effort to collect delinquent debts, but debt collection continues to be a serious problem. Some examples of weaknesses encountered in the credit management area follow.

- We reported recently that the number of outstanding student loans insured by the Department of Education has grown rapidly, increasing by 100 percent from 1982 to 1987. During that same period, defaults increased by 280 percent. Almost 20 percent of all students who received their last loan in 1983 had defaulted by September 1987. We have reported instances where (1) guaranty agencies (federal departments) fail to use available collection tools, such as the IRS tax refund offset, the resources of state offices, and contract collection agencies, (2) guaranty agencies have failed to follow their own collection standards and have not required lenders to do so, and (3) educational institutions admit students who have little chance of success and who are highly likely to default on their loans. (See GAO/HRD-88-72 and GAO/OCG-89-18TR.)
- In 1987 and 1988, the IRS reported a material weakness related to accounts receivable. The fiscal year 1987 report noted that IRS' delinquent accounts receivable balance was about $51 billion—almost threefold the approximately $18 billion reported in fiscal year 1981. IRS' Internal Audit Division estimated that about $33 billion of the balance was collectible, but IRS had little detailed information on how much of the accounts receivable inventory could be collected and did not know what collection tools would be most effective. As a result, IRS has been unable to effectively reduce the growth of accounts receivable and collect delinquent taxes. The IRS contracted with a consulting firm to identify why accounts receivable have grown so rapidly and to discuss the changes that IRS should make in monitoring and reporting on accounts receivable. The consultant issued a final report in April 1988, and, according to the IRS' fiscal year 1988 Financial Integrity Act report, the IRS was studying the report's recommendations. (See GAO/GGD-89-1, GAO/IMTEC-88-41, and GAO/OCG-89-26TR.)

The government has taken several actions to address the credit management problems. The Reagan administration designated OMB as the focal point for debt collection initiatives. In addition, the Congress passed the Debt Collection Act of 1982, Treasury's Financial Management Service issued guidance on credit management and debt collection, OMB prescribed policies and procedures for managing federal credit programs and instructed agencies to follow a nine-point credit management program,[2] and Treasury issued "Managing Government Credit: A Supplement to the Treasury Financial Manual."

Agencies have also reported making progress in improving their credit management. Examples of reported improvements follow.

- Federal agencies have begun offsetting federal employees' salaries to collect delinquent loans. In 1987 and 1988, five major agencies—the Departments of Agriculture, Education, Housing and Urban Development (HUD), Veterans Affairs (VA), and the Small Business Administration—matched their delinquent accounts with federal employment rosters. Over 140,000 federal employees were found to be delinquent on federal debts valued at almost $500 million. The agencies sent the debtors 30-day notice letters and implemented offset procedures. OMB reported that, as of the end of November 1988, employees had repaid $58 million, most of which ($55 million) was from debts owed to the VA and the Department of Education.
- A pilot program, which we recommended in the late 1970s, authorized by the Deficit Reduction Act of 1984, allows delinquent debts owed to the federal government to be offset against tax refunds due to the debtor. The Congress has extended the authority for the program to January 1994. Under the provisions of the act, federal agencies send delinquent debtors notices of intent to offset any tax refund to which the debtor may be entitled. Each year, agencies provide the IRS with a list of those debts that are not repaid, renegotiated, or otherwise resolved for matching against tax returns and subsequent offset of any refund due. As of October 1989, Treasury reported that the offset program had recovered over $1.2 billion in the past 3 years.

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[2] The nine-point program focuses on credit management initiatives in each of the credit cycle phases—loan origination, account servicing, loan collection, and write-offs. To the extent allowed by agencies' legislation, the nine-point program instructs agencies to implement initiatives under each credit cycle phase.

Despite these efforts, the government's need to effectively manage its credit programs has become acute, with delinquencies constantly growing. More emphasis must be placed on the use of available credit management tools, such as private collection agencies and reporting of delinquent debtors to credit bureaus. Agencies must improve their accounting systems to help ensure that management has the information needed to collect the government's delinquent debts. Independent audits of debts owed the government are essential to properly manage debt collection activities.

## Eligibility and Entitlement Determinations

Eligibility and entitlement determinations impact a large portion of America's citizens through programs which affect housing, education, farming, and retirees' lives. Historically, weaknesses in this area have resulted from such factors as applicant fraud, lack of controls over key information, and failure to effectively use management information systems to identify program abusers. The current environment of federal deficits and funding reductions makes it even more imperative to ensure that all decisions concerning eligibility and entitlements are sound. The following section provides examples of weaknesses in this area and actions taken to correct them.

- The Health Care Financing Administration (HCFA), which is responsible for administering the Medicare program, contracts with private firms, often insurance companies, to pay hospital claims. In a January 1987 report (GAO/HRD-87-43), we discussed erroneous Medicare payments and estimated that during 1985, Medicare paid at least $527 million in hospital costs that should have been paid by other insurers. In a November 1988 follow-up report, we noted that HCFA had not acted on our earlier recommendations to strengthen internal controls. As a result, Medicare contractors were still not using available information to collect on claims that other insurers should have paid ahead of Medicare. In one case, HCFA estimated that one of its largest contractors (and a major independent health insurance company from the contractor's state) had not reimbursed Medicare for about $10 million in erroneous claims. We found that the contractor's private business should have paid these claims before Medicare but had not done so. This problem continues in 1989. (See GAO/HRD-87-43 and GAO/HRD-89-19.)
- The Department of Veterans Affairs has cited problems with the Civilian Health and Medical Program (CHAMPVA) since 1983. This program pays for hospital care and doctor visits for certain spouses and dependents of members of the armed forces. The primary weakness concerns

the need for reverification of CHAMPVA eligibility to ensure that only eligible individuals receive benefits. The Department reported that it took action and that the weakness was corrected in 1986; however, VA reestablished it as a material weakness in 1987 after a review by the inspector general revealed that about 19 percent of those receiving benefits were ineligible.

While serious problems remain, some agencies have reported improvements in the eligibility and entitlement area. The President's fiscal years 1989 and 1990 Management Reports noted the following improvements:

- Agencies managing programs where creditworthiness is a criterion for credit eligibility are purchasing credit bureau reports to aid in their decision-making.
- Loan application forms for federal financial assistance have been revised and now include a question as to whether the applicant is delinquent or has defaulted on any federal debt. Furthermore, if a debt is delinquent or in default, agencies cannot provide additional financial assistance until payment is made in full or satisfactory repayment arrangements are made with the agency to which the debt is owed.

These actions will improve the basic internal controls over the programs affected, but they are not sufficiently responsive to the seriousness of the eligibility and entitlement problems the government faces. Programs in these areas are far-reaching and total outlays associated with them are large. More internal control improvements are needed to reduce the possibility of waste and abuse.

## Cash Management

In a June 1988 report (see GAO/AFMD-88-52), we discussed the important task of effectively managing the government's $2 trillion annual cash flow. Managing this amount of funds requires depositing collections promptly as well as making government disbursements and paying bills on time. Over the years, our work has shown that payments to vendors were often made either too early or too late and that advances to grantees were made well before they needed the funds. Legislative efforts to make more timely payments resulted in passage of the Prompt Payment Act.[3] Examples of cash management weaknesses follow.

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[3] The Prompt Payment Act of 1982 (Public Law 97-177; 31 U.S.C. Chapter 39) provides specific criteria to federal agencies for determining due dates on commercial invoices when related contracts do not include payment-timing provisions and requires agencies to pay interest penalties when payments are late.

- In its 1987 Financial Integrity Act report, the Department of Housing and Urban Development reported that inadequate controls in the property disposition process provided the potential for closing agents to manipulate or otherwise take funds for their own use or to delay the transfer of such funds to the Department. Corrective actions, which were scheduled for completion by October 1989, included development of an automated system to provide complete, accurate, and prompt accounting for all properties and funds handled in the property disposition process. The system is designed to provide better control over the management and disposition of properties and improvement of the accounting function associated with the property disposition process.

  This problem continues to exist and has, along with problems in several other HUD programs, recently received widespread news media attention.

- In 1987, VA reported it had not fully complied with the Prompt Payment Act's provisions concerning timeliness and the payment of interest penalties on late payments.[4] Its corrective actions have centered around implementation of the Computer Assisted Payment Processing System which matches vendor invoices with receiving reports. While VA reported progress in paying some bills processed through its system prior to the grace period, it nevertheless continued to experience difficulty in paying certified invoices. In 1988, VA reported further improvements in complying with the Prompt Payment Act and noted that interest penalties had declined from about $430,000 in fiscal year 1987 to about $360,000 in fiscal year 1988. Further, VA stated that it no longer considered the weakness material because these penalties were projected to decline further in 1989 and they were below OMB's threshold for materiality.
- In 1988, the Department of State reported that it was not consistently complying with provisions of the Prompt Payment Act. It reported significant problems throughout the Department involving late documentation and the correction and transmittal of purchase orders, invoices, and receiving reports. In addition, the Department indicated it was still making payments either early or late and, at times, without the proper interest penalty payment. The Department reported taking initial steps to address this weakness. However, it does not anticipate correcting it until

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[4] In October 1988, the Congress passed the Prompt Payment Act amendments of 1988 to provide more specific guidance on the timing of payments and related interest penalties to vendors, to increase the amount of interest penalties agencies must pay to vendors if interest penalties are not made automatically, and to eliminate the grace periods (e.g., a 15-day period after the payment due date during which payments could be made without incurring interest penalties).

fiscal year 1990, when its new Central Financial Management System is fully implemented throughout the Department.

- The Treasury Inspector General's 1988 annual report noted that established policies and procedures for controlling Customs collections, serially-numbered forms, and Government Losses in Shipment Act transmittals were not followed at the Los Angeles International Airport. Consequently, a theft of over $800,000 was not detected for more than a year. The Inspector General's report further noted that on four previous occasions, the internal audit staff had reported the procedural problems which permitted the undetected theft but that corrective actions had not been taken.

The federal government must set new goals and implement strategies for achieving cash savings. Initiatives such as Treasury's plan to have all agencies use electronic certification technology for submitting payment requests to Treasury regional financial centers, and the processing of all Form 1040 estimated tax payments to a lockbox system are helpful. However, agencies must continue to search for efficient cash management techniques and use current and emerging technology to better process payments, collect receipts, and improve overall cash management.

## Automated Data Processing

Technology is transforming how the government does business. Federal agencies currently operate over 53,000 unclassified automated systems, some with life cycle costs in the billions of dollars. According to the President's budget for 1989, by the year 2000, 75 percent of public transactions will be handled electronically. Projected federal expenditures for information technology and management in fiscal year 1989 total about $17 billion as compared to $9 billion in fiscal year 1982. While spending these billions of dollars, federal agencies are experiencing massive problems in acquiring and developing the systems necessary to manage government operations. Invariably, these systems do not work as planned, have cost overruns in the millions and even hundreds of millions of dollars, and are not developed on time. Congressional interest in these matters has increased as the Congress is being asked to fund more and more systems at higher and higher costs. (See GAO/OCG-89-6TR.)

In a 1989 report, we analyzed the ADP weaknesses reported by agencies under the Financial Integrity Act. (See GAO/IMTEC-89-11.) We found that, for the period 1983 through 1987, about 80 percent of the weaknesses fell into 4 categories: (1) controls over computer applications, (2) ADP security, (3) ADP organization and management, and (4) methodology for evaluating ADP controls and security. The following examples illustrate some specific weaknesses occurring in the ADP area.

- DOD spends in excess of $8 billion annually on automated information systems to support military functions such as supply and maintenance, technical data, and manpower management and an additional $22 billion each year on systems for command, control, and communications. In recent years, we have reported that many of these Defense systems far exceeded their original cost estimates, became operational later than scheduled, and fell significantly short of originally approved performance expectations because of design flaws, misjudgments in requirements, and poor program management. For example, in a September 1988 report, we noted that the project costs for the Standard Automated Financial System, which the Navy initiated in 1980, had grown from an estimated $33 million to $479 million, a staggering fifteenfold increase. Although faced with dramatic cost increases to develop and implement this system, the Navy did not adequately explore alternatives. In January 1989, after spending 9 years and an estimated $230 million on the project and facing opposition from most users who doubted the system could be successfully deployed, the Navy judged the system to be too costly and halted its installation. (See GAO/IMTEC-88-47, GAO/T-IMTEC-88-7, and GAO/T-OCG-89-27.)
- In 1984, the IRS expanded its Automated Examination System for tax returns. The expanded project was to be completed by 1989 at a cost of $1 billion. Since the 1984 expansion, the cost estimates have risen by $800 million, the schedule has been delayed by 6 years, and the IRS has been unable to conclusively demonstrate benefits from the one portion of the system that is operational. Because few benefits can be cited as a result of already spending $187 million through 1988, the IRS has requested no further development funds for fiscal year 1990.
- The Department of State has reported multiple weaknesses relating to ADP since 1984. These weaknesses include: (1) lack of alternate computing capability in the event that a disaster or terrorist act should close the Department's only main computer complex or its regional computer sites, (2) inadequate security and control over automated information systems, (3) poor environmental controls at the Department's main computer complex (inoperative humidity controls, water leakage through the roof, frequent air conditioning failures, and failure by the General Services Administration to maintain backup generators in the event of a power outage), (4) environmental deficiencies at the regional administrative management centers in Paris, Bangkok, and Mexico City, and (5) lack of documented contingency plans or procedures in the event of a

long-term power outage. Although the Department has reported progress in correcting some of these weaknesses, most scheduled completion dates range from 1989 to 1992.

These examples and others reported by agencies and GAO show that agencies across the government have problems implementing automated information systems. In June 1989 testimony, we noted that, for the most part, these problems are not caused by a lack of regulations, policies, or procedures but are caused by some of the following. (See GAO/T-IMTEC-89-9.)

- Agency needs are not clearly identified, leading to inadequate definition of requirements.
- Alternative approaches are not considered; too frequently, agencies seek unique solutions for common application needs.
- Problems in software development or system configuration are often deferred to the next development phase and are not addressed before moving on.
- Determinations of system needs and requirements continuously change, leading to cost overruns and schedule delays.
- Top managers and congressional leaders are not always provided with accurate cost and schedule estimates.
- Managers are frequently reluctant to make the tough decision to terminate a poor development effort; instead, they choose to spend additional funds in an attempt to solve the problem.
- Program management responsibility frequently changes and is often poorly defined.
- Top agency management is not adequately involved in system development.

Top agency management needs to become more involved in information management decisions, to recognize the role and importance of strategic planning in guiding information resource activities toward achieving the agency's mission, and to review these plans and update them periodically to ensure their applicability and usefulness.

Managers at all levels must give increased attention to managing information and information resources, but in order to do this, managers must educate themselves in how to manage information and information resources. Agency management needs to ensure that individual system projects are developed in accordance with the strategic plans, that program managers follow more strictly established system design and acquisition procedures, and that strategic plans are consistent with budget requests and agency reprogramming actions. System requirements should be adequately defined, alternative solutions fully evaluated, and the costs and benefits of alternatives assessed. Finally, managers must be willing to look beyond familiar parameters—the private sector has much that we can learn in the areas of information skills and application.

## Property Management

Property constitutes a large percentage of the government's total assets. At the end of fiscal year 1987, Treasury reported in the Consolidated Financial Statements of the United States Government, Prototype, that property, plant, and equipment (net of depreciation) was over $450 billion or about 40 percent of the government's total reported assets. To ensure that the government's investment in property is safeguarded and maintained and that property is accounted for and properly used, sound internal controls are necessary.

Over the past 7 years, DOD's property management weaknesses have involved areas such as property furnished to contractors, inventory inaccuracies, materials-in-transit, and inventories of secondary items. The following are examples of some of these weaknesses.

- Since 1967, GAO has raised concerns about property furnished to Defense contractors. In 1981, DOD directed the services to establish management control activities to maintain control over access to government furnished materials. However, a March 1988 GAO report indicated that, while more than 6 years had passed since DOD required better controls over contractor access to the DOD supply system, poor controls were still evident in the Army. In 1988, DOD estimated that, as of September 1986, the amount of government furnished material in the possession of Army contractors was about $2 billion. GAO found that the Army had made little progress in implementing the management control and reporting systems that DOD requires to adequately control government furnished material provided to contractors. Also, the Army had not yet developed an accounting system that would provide an independent means of identifying how much government furnished material the contractors had on hand and received annually and how it was being used. These control weaknesses offered the potential for fraud, waste, and abuse of government furnished materials. DOD agreed with our findings and stated that the Army had not been as aggressive as it should have been in implementing existing DOD policies for instituting controls in this area. (See GAO/NSIAD-88-98.)

- In a July 1988 report, GAO discussed the increase in the value of spare parts inventories at DOD and concluded that, while much of this growth resulted from increased costs due to inflation and the need to support weapon systems modernization, a sizable portion represented unneeded inventories. The amount of unneeded secondary items increased from approximately $10 billion in 1980 to about $29 billion in 1988. More efficient inventory management by the military services and defense agencies could reduce these inventories, which could free defense dollars for other areas without reducing readiness. (See GAO/NSIAD-88-189BR and GAO/OCG-89-9TR.)

The Department of Defense is not the only agency experiencing weaknesses in property management. The following examples show that they exist elsewhere in the government.

- Since 1984, VA has reported that pharmaceuticals from its hospital ward Inpatient Drug Distribution System have been susceptible to unauthorized use or loss. According to VA's 1988 Financial Integrity Act report, its Department of Medicine and Surgery is in the process of implementing a new medication disbursement system to reduce access to medications. In addition, VA reported that it has converted approximately 70 percent of the medical facilities to the new system and that its central office pharmacy service monitors those facilities that have not yet been converted. VA's 1988 Financial Integrity Act report also included this condition as an uncorrected material weakness. It further noted that while no funds had been allocated to continue the conversion process in fiscal year 1988, VA would continue to monitor those facilities which had not yet been converted.
- Over the past 18 years, numerous reports by GAO, and more recently by the State Department's Inspector General, have reported inadequate internal controls over personal property located at about 260 foreign posts and 21 domestic cities. This condition occurred because the Department neither followed regulations nor took proper enforcement actions. State Department officials have repeatedly promised, but not taken, corrective actions.

In a related example, GAO reported that, because of years of neglect, serious maintenance problems now exist at a number of the government's owned and leased overseas properties. This occurred in part because the responsibility for identifying maintenance needs typically rests with foreign service generalists who do not have the technical skills needed to assess maintenance problems. State officials have acknowledged that a serious maintenance backlog exists and estimate that about $1 billion would be needed to provide necessary maintenance and repairs. (See GAO/NSIAD-87-156, GAO/NSIAD-89-115, and GAO/OCG-89-19TR.)

While the government has a large investment in property, its problems in this area have been particularly long-standing. Agencies must improve the internal control and accounting systems designed to control and manage federal property and reduce the potential for waste and abuse of federal funds.

## Financial Management and Accounting Systems

The federal government faces a major fiscal crisis. Effective measures must be taken to control the continuing budget deficits and reduce the massive accumulated federal debt. Hard choices must be made; however, their effectiveness can be affected by the quality of the financial information and ultimately the adequacy of the underlying financial management systems. Many federal financial systems are weak, outdated and inefficient, and cannot routinely produce relevant, timely, and comprehensive information. As a result, managers and the Congress are denied the opportunity to know the real financial effects of past decisions and the potential costs and benefits of alternative actions.

The basic structures of many present federal financial management systems were designed during World War II. The result is that financial reports provide a flood of information but little reliable operational and cost data that are essential to monitor programs, anticipate overruns, and provide a basis for program and budget planning. The ongoing HUD debacle underlines this problem. The systems could not provide basic accountability and control. Our recent financial audit of the Federal Housing Administration, for example, showed that while the administration's system showed losses of about $860 million, in fact the losses were $4.2 billion, or almost 5 times higher.

Hundreds of millions of dollars are spent each year on uncoordinated efforts to upgrade these systems. Despite improvement efforts over many years, the systems are still second rate. As the President's fiscal year 1989 Management Report states, "Once a leader in the early days of automation, the Government's financial systems and operations have eroded to the point that they do not meet generally accepted standards."

Conventional efforts to put the government's financial house in order have lacked the long-term, governmentwide approach that is necessary to ensure that consistent data are available across agency and department lines. The reform effort needs centralized leadership, which is tasked with developing a long-range plan to guide the reform activities and corresponding financial management positions in the agencies.

In 1985, we issued a report entitled, *Managing the Cost of Government*, which was the culmination of a major study of the government's financial management practices. The report identified significant problems affecting the federal financial management structure, proposed a conceptual framework to guide improvement efforts, and provided an implementation strategy. Since then, we have seen a growing consensus as to the need to reform the government's financial management systems and as to what needs to be done throughout the government to accomplish meaningful and lasting improvements. (See GAO/AFMD-85-35 and 35A, and GAO/OCG-89-7TR.) Some examples of the continuing accounting system weaknesses that plague government programs follow.

- GAO first identified major accounting and internal control weaknesses related to the Foreign Military Sales trust fund more than 10 years ago. Because of a long-standing lack of accounting control over trust fund cash and related bills to customer countries, the federal government might have to refund millions of dollars to foreign governments. In 1982, after 6 years of largely unsuccessful efforts to improve accounting in this program, DOD established a Foreign Military Sales Financial Management Improvement Program under the defense comptroller, through which DOD developed a comprehensive plan to correct deficiencies. The centerpiece of the plan was the Defense Security Assistance Agency's (DSAA) new central system. The plan also included the development of interfacing systems in each military department. However, the plan failed, and in July 1988, in an effort to redirect faltering system development efforts, the Deputy Secretary of Defense reassigned responsibility for operating the existing system and developing an improved system from DSAA to the Air Force. (See GAO/T-AFMD-88-9 and GAO/AFMD-88-75.)
- The United States Mint has accounting problems which need management attention. In a 1989 report on the Mint's financial management system, GAO identified several internal control weaknesses including inadequate accountability for coin dies, outdated and incomplete policies and procedures for cost accounting and budgetary funds control, and inadequate training and supervision of accounting staff. In addition, the Mint incorrectly accounted for costs in recording revenue and expense information and used inappropriate methodologies to distribute certain overhead costs between the businesslike numismatic, or collectors' coin,

programs and the appropriated domestic coin programs. As a result, certain numismatic coin program revenue and expense reports were unreliable, and the Mint cannot ensure that these programs operate at no net cost to the government. Also, funds control reports contained errors and did not show balances available for obligation, and the Mint cannot ensure that obligations do not exceed authorized funding. (See GAO/AFMD-89-88 and GAO/T-AFMD-89-12.)

- Key accounting and related internal control systems currently operated by the Department of Health and Human Services (HHS) have serious weaknesses. As discussed in a September 1988 GAO report and subsequently reported in HHS' 1988 Financial Integrity Act report, differences between the balances recorded in the HHS operating divisions' accounting systems and internal and external financial reports amounted to billions of dollars. As a result, HHS did not know the amount of funds it had available, the amount of advances made to grant recipients, and the amount of property it was responsible for controlling. Also, efforts to collect approximately $31 million in audit disallowances have been hampered by inadequate documentation, untimely recording of accounts receivable, and the lack of written debt collection procedures. Over the past 10 years, HHS initiated two major departmentwide accounting system enhancement efforts, but neither was successful. (See GAO/AFMD-88-37.)
- In 1987, the Department of Education identified two material weaknesses related to guaranteed student loan interest subsidy payments. Supporting documentation for the report noted (1) interest subsidy billing errors of $121 million due to lenders' overstatements of loan account balances and incorrect classifications of loan and student status and (2) missing documentation in lenders [illegible]s for individual borrower accounts associated with $417 million of payments. The program's controls (edit checks) were not sufficient to detect most lender errors. The Department stated that it was upgrading the interest billing subsystem by building stronger controls, and reported, in 1988, that it expected to complete corrective actions by 1991.

In the past, successful completion of financial management improvement efforts has often been elusive. Currently, there is an emerging consensus within the Congress and the executive branch that effective and lasting improvement must be sustained across administrations and guided by a cohesive framework under centralized leadership.

The administration's strategy for improving the government's financial management systems involves consolidating and standardizing the government's many separate financial management systems by establishing a single, primary accounting system in each major agency. Agencies are required to follow the minimum system standards set out in the Joint Financial Management Improvement Project's Core Financial System Requirements, select off-the-shelf software, and eliminate redundant systems through the use of cross-servicing arrangements whereby one agency provides data processing and accounting services for one or more other agencies.

In addition, in July 1987, the Director of OMB appointed a Chief Financial Officer (CFO) of the United States to provide leadership, policy direction, and oversight for federal financial management, and, in November 1987, recommended that each of the major agencies create a chief financial officer position within its organization. Subsequently, OMB created a council of these officers to provide advice and assistance to the CFO of the United States.

Over the past several years, interest in a legislatively established chief financial officer position for the federal government has increased. Bills introduced in the 99th and 100th Congresses called for a CFO, and the President's Management Report for fiscal years 1989 and 1990 pointed to the need for a legislatively mandated CFO. GAO has called for the establishment of a legislative CFO that would develop a long-range, governmentwide financial management plan and provide direction and continuity when leadership changes occur in the administration as well as at the agency level. (See GAO/T-AFMD-88-18.)

Experience has shown that management reforms are more likely to succeed if they have a legislative mandate. As noted in May 1986 testimony, GAO studied centrally directed, governmentwide management improvements conducted in the 1970s and found that few initiatives had a lasting impact. For problems as complex and long-standing as those of federal financial management, there are no magical solutions. The situation can be righted only through painstaking, long-term efforts. However, short-term actions which are very productive can and should also be taken. Legislation may not solve every facet of the problem, but it will provide a permanence that is absent from administratively based initiatives. Further, a statutorily mandated CFO for the government and corresponding positions in the agencies would give financial management the prominence necessary to achieve reform. Such action will also enable the federal government to better manage its financial affairs, save billions of dollars, and help restore the accountability of managers and the credibility of government.

## Personnel and Organizational Management

A key factor in the development, implementation, and maintenance of strong internal control systems is the competence and motivation of the federal workforce. Today, the federal government is challenged by a number of personnel concerns. It needs to attract, motivate, and retain committed people at all levels who can develop new ideas and innovative approaches and see them through to effective implementation. Concern is mounting over the impact that both the federal pay structure and the turnover in leadership positions are having on the government's ability to acquire and retain top quality people to carry out its programs.

The federal government's pay structure has deteriorated. The result of this deterioration has been that over half of all federal personnel officers we surveyed in 1987 said that their ability to hire competitively over the last 5 years had worsened. The Federal Aviation Administration, the Internal Revenue Service (IRS), and the Social Security Administration have had substantial difficulty attracting or retaining air traffic controllers, revenue agents, and computer specialists, respectively. Over half of the government's senior career executives we surveyed said they would likely accept a desirable position outside the federal government if one became available. The following are some examples of weaknesses in personnel and organizational management.

- GAO has testified more than 20 times in the past 2 years on personnel problems affecting the operation of the Federal Aviation Administration's (FAA) air traffic control system. FAA does not have a recruitment policy or a coordinated recruitment program and is finding it difficult to attract and retain high quality personnel. Today, 8 years after the 1981 air traffic controllers' strike, there are almost 4,000 fewer fully qualified controllers than before the strike. Moreover, shortages of inspectors and maintenance technicians are having an adverse impact on FAA's ability to cope with increasing levels of air traffic.
- In an October 1988 report, we noted that the IRS had recognized the need to improve its ability to attract and retain a high quality financial management and accounting work force. For example, IRS-furnished statistics for regional accounting section staffing showed turnover rates in excess of 25 percent. The IRS identified several factors that hindered its attempts to solve this problem. First, a large number of people living in some of the communities where IRS has its service centers did not have the needed accounting knowledge and experience for accounting technician positions. Second, in those localities where qualified people live, the IRS was often at a disadvantage because the private sector paid higher salaries. Finally, when accounting technicians reach the journeyman

level, they face extremely limited prospects for continued advancement in the accounting section. (See GAO/GGD-89-1 and GAO/OCG-89-26TR.)

- In a July 1988 report, we discussed a DOD personnel problem concerning the validation of physicians' qualifications and the adequacy of documentation in credential files. Validation, which should be documented, is an important step to ensure that practicing military physicians are qualified. In July 1985, DOD stated that by July 1988, it would require its physicians to have a valid, current state medical license. However, as of May 1988, many DOD physicians were still unlicensed.

Another example of personnel and organizational management weaknesses relates to the DOD hospital quality assurance review of patient records. This review identifies occurrences that deviate from normal medical procedures or expected outcomes. Once identified, an occurrence is evaluated by physicians, who determine whether the care given was appropriate and met acceptable medical standards. In a January 1989 report, we stated that DOD's initial screening process did not identify a substantial number of deviations which had occurred. We identified three factors that contributed to this situation: (1) DOD and the services had not provided sufficient guidance on what to do if more than one deviation was found in a patient's record, (2) in the Navy, corpsmen reviewing patient records may not have had sufficient medical expertise and training to identify all of the deviations, and (3) in the Army and Air Force, physicians ~~screen their own~~ patient records. DOD made policy changes in 1986 and 1987 to improve the utility of occurrence screening programs at the hospital level in order to achieve more positive acceptance of the program by the hospitals. The extent to which these changes help will depend on how the hospitals and services design and implement their programs within the revised policy framework.

The range of personnel and organizational management problems cited thus far involve individuals' recruitment, retention, or qualifications, and organizational considerations such as separation of duties. However, differences in management philosophy can also affect how well an agency fulfills its mission. The following example illustrates this point.

- The Secretary of Energy recently pointed out significant personnel and organization weaknesses within the Department of Energy (DOE) which also impact such key departmental functions as environmental protection and waste management. The Secretary stated that he strongly disagrees with the "...underlying operating philosophy and culture of DOE, ... that adequate production of defense nuclear materials and a healthy, safe environment were not compatible objectives." In 1988, DOE did report multiple weaknesses causing significant environmental problems at its facilities which may take as many as 20 years and as much as $95 billion to correct. Although these weaknesses have been identified and corrective actions indicated, the newly appointed Secretary stated that he will undertake his own assessment of all DOE operations and that he "... will not be driven by previously set schedules or management decisions which still do not answer emerging questions as to the soundness of technical data or completeness of reviews." The Secretary of Energy has proposed ten initiatives intended "... to restore credibility to the Department of Energy, and to provide the kind of environmentally responsible direction that is critical ..." to meet DOE's mission.

The identification of new material weaknesses, continued existence of previously reported weaknesses, and detrimental effect of internal control and accounting system weaknesses such as those discussed in this chapter lend credibility to the concerns of the Congress and the American public that the federal government is not effectively and efficiently managing its programs. They show a need for greater top-level management emphasis on ensuring strong internal control and accounting systems in all federal programs and for actions to improve the governmentwide efforts to implement the act. Later in this report, we recommend several actions that the Congress and OMB can take to satisfy these needs.

Chapter 3

# Agency Management Perceptions of the Financial Integrity Act

At the time the Congress passed the Financial Integrity Act, federal managers' primary interests focused on achieving program goals, with little interest in program efficiency and economy. As a result, we saw a continual stream of reported incidences of fraud, waste, and abuse stemming from weak internal control and accounting systems. Although widespread serious weaknesses continue to exist in the internal control and accounting systems throughout federal programs, the results of GAO questionnaires and discussions with agency managers and audit officials show that agencies have made progress since 1982 in establishing the self-evaluation programs called for in the act. Federal managers generally perceive that the Financial Integrity Act has had a positive impact on their activities, and that, overall, their internal control systems have improved.

Nevertheless, implementation problems remain. The questionnaires revealed that a significant number of components still had not received the required evaluations of their internal control systems, and about 50 percent of the managers responsible for performing the internal control assessments and evaluations have not received any training concerning the act and the work required to comply with its provisions. Further, an Internal Control Interagency Coordination Council report highlighted a number of actions to improve the governmentwide Financial Integrity Act efforts in the evaluation, reporting, and corrective action areas.

In this chapter, we will present, on a governmentwide basis, historical information on the internal control evaluation activities of the 18 major federal agencies and the perceptions of managers and audit officials within those agencies on the act in general and the benefits and problems encountered as a result of implementing it. Unless otherwise noted, our analysis is based on the responses of over 1,400 component managers and senior agency executives[1] from the 18 agencies included in our review.

## GAO's Survey of Agency Managers

We used two questionnaires and structured interviews to collect information on agency efforts to implement the act. We distributed one questionnaire to a statistically representative sample of component managers and the other to the senior executives in each agency. The questionnaires focused on individual manager experience with and perceptions of the act. In addition, we interviewed each agency's inspector general (IG) or chief audit official and chief internal control official to obtain their perceptions of the act. (See appendix III for a discussion of the scope and methodology used in developing and administering these data collection instruments and appendix IV for a copy of each questionnaire and summary of the responses received.)

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[1] Component managers are responsible for an agency component, which OMB defines as "a major program, administrative activity, organization, or functional subdivision of an agency." Agency senior executives are assistant secretaries or executives of an equivalent level.

## Agency Knowledge of the Condition of Internal Controls Before the Act

Agency senior executive and component manager responses to the questionnaires show that, prior to 1983, most federal agencies had established processes for evaluating their internal control systems. Our interviews with the IGs and chief internal control officials confirm the existence of such processes. These officials, however, generally characterized the processes as informal and limited in scope (usually to a location such as a hospital, management center, military base, or function, such as payments). Overall, they lacked the formal reporting procedures needed to focus top management's attention on the problems identified. The Financial Integrity Act provided this structure.

## Managers Report Significant Financial Integrity Act Efforts

The act requires ongoing evaluations of agency internal control systems. The results of these evaluations form the basis of the agency head's annual report to the Congress and the President on the condition of controls within each agency. The guidance developed by OMB for agency use in implementing the act provides for two evaluation activities—risk assessments and internal control evaluations. Managers reported conducting about 90,000 of these evaluations from 1983 through 1987.

### Managers Perceive That Risk Assessments Achieve Their Intended Objectives

The first step in evaluating internal controls is the assessment of an agency component's risk or susceptibility to waste, loss, unauthorized use, or misappropriation. Agency personnel accomplish this task by performing risk assessments. We found that the number of risk assessments conducted has steadily increased since 1983 and that managers gave this process high marks in measuring the susceptibility of their programs.

In conducting risk assessments, agencies may follow the procedures outlined in OMB's Financial Integrity Act implementing guidelines or use other systematic reviews that build on management's knowledge, information obtained from management reporting systems, previous risk assessments, audits, and other sources. The three basic steps in these assessments are

- analysis of the general control environment,
- analysis of the component's inherent risk, and
- preliminary evaluation of the controls in the component.

Our questionnaire results show that, since passage of the act, the number of units performing risk assessments has steadily risen each year, from 6,443 (35 percent of the 18,319 total agency components) in 1983 to 10,656 (58 percent) in 1987. Ninety-three percent of the component managers judged the most recent risk assessment as adequate or better in rating their component's susceptibility to waste, loss, unauthorized use, or misappropriation. In addition, as a preliminary internal control system evaluation methodology, risk assessments are not expected to identify material internal control weaknesses. However, about 24 percent of the component managers indicated that the assessments identified material internal control weaknesses, with about 13 percent saying that the process identified this type of weakness to a great or very great extent.

## Agencies Are Conducting Internal Control System Evaluations and Identifying Material System Weaknesses

The number of internal control evaluations conducted each year since 1983 has also increased. These evaluations are detailed reviews of an agency component's internal control systems to determine whether those systems meet the control objectives established in the act. Managers almost unanimously viewed them in positive terms and report that these evaluations have identified material internal control weaknesses in their programs.

An internal control evaluation may consist of the procedures outlined in OMB's Financial Integrity Act guidelines or the alternative procedures identified in OMB Circular A-123, "Internal Control Systems." These alternative procedures include reviews made under OMB Circulars A-76, A-127, and A-130,[2] inspector general and GAO audits, management studies, and consultant reviews.

Federal agencies have been very active in conducting internal control evaluations. Questionnaire results show that the number of these detailed reviews performed has increased each year since 1983, going from a low of 6,888 in 1983 to a high of 11,117 in 1987. Since implementation of the act, the 18 agencies included in our review have conducted about 50,000 internal control evaluations.

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[2] These OMB circulars require agencies to report on in-house activities and acquisition of commercial type products and services (Circular A-76), financial management systems (Circular A-127), and information resources, including ADP and telecommunications (Circular A-130).

Managers gave these evaluations high marks. Ninety-four percent of the component managers stated that the internal control evaluations did an adequate or more than adequate job of portraying the condition of the control systems in their programs. About half of the evaluations identified material internal control system weaknesses to at least some extent, and 16 percent of the evaluations identified material weaknesses to a great or very great extent.

Based on OMB guidance, agency managers should conduct internal control evaluations in areas judged to have a high or moderate risk of loss based on the risk assessment results. However, our questionnaire results showed that a component's risk rating was not a factor in determining which components had an internal control evaluation. Components with high risk ratings were no more likely to have an internal control evaluation than those with low or medium risk ratings.

However, a clear relationship exists between the number of risk assessments an agency component had and the component's involvement with internal control evaluations. Those with two or more risk assessments (group one) were significantly more likely to have had an internal control evaluation than those having one or none (group two). Almost 90 percent of the group one components received at least one internal control evaluation during calendar years 1983-1987. In addition, group one component managers were somewhat more directly involved in all aspects of the Financial Integrity Act work in their components than their group two counterparts. For example, nearly 71 percent of group one managers conducted the last internal control evaluation in their component as opposed to 62 percent of group two managers.

## Agency Actions to Correct Material Weaknesses

The underlying purpose of the act is to improve agency internal control systems; prevent and detect fraud, abuse, waste and mismanagement; and increase the efficiency and effectiveness of federal agency operations and programs. The identification of material internal control weaknesses is an important first step in this process, but, for the Financial Integrity Act program to work, agencies must take the next step and correct the weaknesses detected. This is the central problem facing government today. For the most part, we believe agencies are aware of their major problems. HUD is a case in point. The problems that gave rise to the infamous "Robin HUD" case were identified and reported in HUD's 1987 Financial Integrity Act report. Where HUD fell down was in not promptly and effectively correcting the problem. Management support is critical in order for agencies to eliminate serious and oftentimes long standing internal control system weaknesses, such as those highlighted in chapter 2.

## Managers Perceive Agency Support for Corrective Actions

Senior agency executives and component managers generally believe that their agencies have supported actions to correct identified internal control weaknesses and that they are working to correct those problems.

- About 90 percent of the senior executives said their agency supports actions to correct identified material weaknesses from a moderate to very great extent, and 79 percent felt that, from a great to a very great extent, their agencies implemented corrective actions. About 80 and 60 percent of the component managers, respectively, responded the same way.
- Only 7 percent of the managers felt that their agencies took little or no action to correct the weaknesses identified, and 7 percent indicated that agency actions had little or no effect on resolving the weaknesses.

Managers identified the following as ways their agencies demonstrate support for corrective actions.

- Agency heads distribute memos/letters discussing the importance of agency efforts to strengthen internal controls.
- High-level agency management is directly involved in determining the needed corrective actions.
- High-level agency management is directly involved in implementing corrective actions identified.
- The agency has provided additional funds to make the needed changes.
- The agency has increased staffing to implement and maintain improved internal control systems.
- Agency management is involved in follow-up procedures to determine the timeliness and effectiveness of corrective actions.
- The agency requires training in internal control system reviews and methods to correct weaknesses identified.

We found a positive relationship between the number of risk assessments conducted in a component and the level of management support for the Financial Integrity Act program. Managers of components having two or more risk assessments were more likely to follow up to ensure that the corrective actions taken resolved the weakness identified than managers of components having one or no assessments. In addition, their responses indicated that they received stronger top management support, were more likely to get additional funding and staff, and that agency management followed up more often to determine the effectiveness of corrective actions than was the case for the other group of managers. In addition, they perceived that they obtained more results from their efforts (i.e., their efforts resulted in improvements in the efficiency of their program's operations and controls) than those managers involved in programs where one or no risk assessments had been performed.

Twenty-nine and 43 percent of the senior executives and component managers, respectively, many of whom also identified ways in which their agencies supported corrective actions, cited areas where agency support for correcting internal control system weaknesses was lacking. These areas include the need for more staffing, more funding, and improved training.

## Cost-Effectiveness of Agency Actions to Strengthen Internal Controls

While strong internal control systems are the cornerstone of effective and efficient management, they must be cost-effective. They should not be developed and implemented just for the sake of having them. Agency management must compare the projected cost of evaluating existing control systems, and developing, implementing, and maintaining internal control and accounting systems against the potential losses, financial and other, that could result from not having those systems.

We asked the senior executives and component managers the extent to which improvements resulting from the Financial Integrity Act evaluations justified the costs to evaluate the internal control systems. Overall, their response was positive. Eighty-six percent of the senior executives responding felt that the benefits obtained justified, to some or a greater extent, the costs incurred. Seventy-one percent of the component managers responding answered in the same way.

Agency executives and component managers identified a number of benefits resulting from the efforts to implement the act and evaluate agency internal control systems. The benefits identified by both groups of respondents follow.

- Management attention has been focused on solving long-standing problems.
- Efficiency and effectiveness in accomplishing program missions have improved.
- The Financial Integrity Act has helped identify actions to improve the efficiency and effectiveness of operations.
- Managers have better control over operations.
- Internal control evaluation activities have helped managers set priorities.
- Program or activity personnel are more aware of the importance of strong internal controls.

About one-third of those managers whose questionnaires indicated that the benefits justified the cost to only some or no extent (about 10 percent of the total respondents) cited one or more of the following reasons for this perception.

- Implementing the act required too much paperwork.
- The work required the participation of too many staff.
- Review efforts duplicated other work.
- Program controls were already considered adequate.
- The process did not identify any weaknesses not already known.
- Financial Integrity Act efforts identified only insignificant weaknesses.

The first three of these items were serious concerns in the early years of the act. In our second governmentwide report on the act's implementation (GAO/AFMD-86-14, December 1985), we cited the widespread concern that managers viewed the implementation of the Financial Integrity Act as a meaningless paper exercise that accomplished little beyond adding to their paperwork burden. There was a general perception that the paper-intensive implementation processes used by agencies diluted the act's merits.

A 1985 report prepared by the President's Council on Management Improvement (PCMI) confirmed that, while agencies recognized the need to strengthen their internal controls, they considered paperwork for risk assessments and internal control evaluations to be excessive. The study team recommended, among other things, that changes be made to reduce the effort expended on risk assessments and internal control reviews without compromising the act's objectives.

OMB has, through revisions to Circular A-123 and other documents, provided agencies with the flexibility needed to reduce the paperwork.

staffing, and duplication problems. In revising Circular A-123 in 1986, it amended the guidance for risk assessments and internal control evaluations and permitted the use of alternative procedures, such as audit and other reports in meeting the requirements of the act. So, while some managers still see a paperwork burden, our survey results clearly show a significant decrease in managers' concerns in these areas since the 1985 PCMI study. We also believe this indicates that a cultural change may be taking place and that managers better understand and accept their management responsibility for internal controls.

## Questionnaires Identify Areas Needing Improvement

In addition to the perceptions discussed in the preceding section of this chapter, the questionnaires collected information on the involvement of component managers in several areas instrumental to the act's success. Two such areas are involvement in risk assessments and internal control evaluations and receipt of training in Financial Integrity Act areas. In both areas, the component manager questionnaires identified problems that could raise questions as to whether federal agencies are serious in their efforts to implement the act and are somewhat counter to the perceptions discussed earlier in this chapter. First, a significant number of the components within the 18 agencies included in our review had received too few risk assessments or internal control evaluations from 1983 through 1987. In the second area, only about 50 percent of component managers had received training related to the evaluations required under the act and their agency's processes for implementing those requirements.

### Inadequate Number of Internal Control System Evaluations Conducted on Agency Components

When passing the Financial Integrity Act, the Congress intended that agencies conduct ongoing evaluations of all aspects of their internal control systems. While the numbers of evaluations conducted have steadily increased each year, a significant percentage of agency components had received an insufficient number of evaluations.

OMB prescribed timeframes within which agencies should conduct risk assessments of their components. This guidance, as presented in OMB Circular A-123, initially required agencies to perform these assessments on all components at least once every 2 years. In 1986, OMB revised A-123 and, among other things, changed the 2-year review cycle to a 5-year cycle or earlier as major changes occur. GAO believes that each agency, if serious about implementing the act, should have reviewed the controls in each component at least twice during the 1983 through 1987 time period.

Based on the results of our questionnaires, we found that about 3,450, or 19 percent, of the components received one or no evaluations from 1983 through 1987. More specifically, 2,408, or 13 percent, received no evaluations, 377, or 2 percent, received one internal control evaluation and no risk assessments, and 663, or 4 percent, received one risk assessment and no internal control evaluations. Considering the importance of internal controls to the efficient and economical operation of federal programs and the congressional interest in strengthening these controls throughout the government, the 19 percent represents an unacceptably high number of components whose systems have received an insufficient number of reviews. This must be changed in the future to fully gain the benefits the act has to offer.

## More and Better Training Are Needed in Financial Integrity Act Issues

Another disappointing statistic coming from the questionnaire analysis is that only a little more than half of the component managers had received training on risk assessments and internal control evaluations. The most common types of training received were formal classroom and on-the-job training. The majority of those receiving this training felt that it was adequate or better.

Despite the general satisfaction expressed by those who had received training, about half of the component managers receiving training identified areas in which their agencies could improve that training in the risk assessment and internal control evaluation areas. They cited one or more of the following as needing improvement.

- Defining the purpose and objective of internal control evaluations.
- Identifying the methodology to be used in evaluating internal controls of ADP systems.
- Identifying the procedures required to perform evaluations.
- Explaining how to analyze and evaluate the results.
- Identifying the documentation needed to support the evaluations.

Managers' perceived training needs varied depending upon the number of assessments that their components had received under the Financial Integrity Act. For example, managers of components having two or more risk assessments cited the need for guidance in conceptual areas, such as the definition of materiality or selection of weaknesses that should be included in the agency report. Managers having one or no risk assessments tended to identify training needs in areas dealing with the basic implementation of the act. For example, they wanted answers to questions dealing with how to conduct risk assessments and internal control evaluations and information on who is responsible for conducting those evaluations.

On January 25, 1988, the Internal Control Interagency Coordination Council, an organization composed of representatives from all the major agencies, OMB and GAO, wrote to the Director of the Office of Personnel Management (OPM) citing the need for improvements in OPM-offered internal controls training for managers. The Council was concerned that most available OPM training did not adequately distinguish between program controls and accounting system controls and, therefore, failed to serve the needs of the majority of managers with responsibility for controls in program areas. It is working with OPM to develop a revised training course and has established a task force to study training needs, evaluate current curricula, and make recommendations. Expedited action in this area is needed as the Council first raised its concern over the adequacy of training almost 2 years ago.

## Agencies Have Identified Opportunities for Strengthening Financial Integrity Act Activities

Federal agencies have recognized and reported on several other aspects of Financial Integrity Act implementation needing improvement. In 1985, the President's Council on Management Improvement conducted a study designed to identify ways to improve and streamline the Financial Integrity Act evaluation and reporting processes. As noted earlier in this chapter, its report resulted in several changes in the governmentwide efforts to implement the act.

In March 1989, the Internal Control Interagency Coordination Council formed a subcommittee composed of representatives of seven agencies, OMB, GAO, and the President's Council on Integrity and Efficiency (PCIE) to review aspects of the government's Financial Integrity Act activities. Specifically, the subcommittee examined the feasibility of integrating or consolidating the review requirements of various OMB circulars, enhancing the usefulness and acceptability of the Financial Integrity Act's internal control review and reporting process to senior agency management, and improving the effectiveness of the Annual Statement of Assurance to the President and the Congress.

The subcommittee's report highlighted the following seven issues:

- linking the internal control review and reporting process with the budget to assist the Congress and OMB in analyzing the impact of corrective actions on agency resources,

- emphasizing the early warning capabilities of the internal control process to ensure timely actions to correct weaknesses identified,
- consolidating the review processes of various OMB circulars to eliminate overlapping review requirements and improve staff utilization,
- providing for and promoting senior management involvement in the internal control process to ensure more effective and lasting oversight and accountability in Financial Integrity Act activities,
- highlighting the most critical internal control weaknesses included in the Financial Integrity Act reports to increase the usefulness of the report to the President and the Congress,
- reporting on agency processes to validate actions taken to correct material weaknesses, ascertain that desired results were achieved, and reduce the likelihood of repeated occurrences of the same weaknesses, and
- improving management awareness and understanding of the act to provide for more consistent program manager interpretation and acceptance of the act.

(Appendix V contains a detailed discussion of each issue area.) The Council forwarded the report to the President's Council on Management Improvement on July 6, 1989, and briefed the Chief Financial Officers' Council on the report on July 19, 1989. Implementation of the recommendations contained in the report, which we fully support, if taken across the government, should have a significant impact on the condition of internal controls over federal programs.

## Audit and Chief Internal Control Officials See Benefits From the Act

We interviewed agency audit officials and chief internal control officials to obtain their perceptions about the success of the act and any areas where improvements might be made. While agency audit officials (inspectors general and chief audit officials) have no legislative responsibilities under the act, they have played an important role since the outset. The results of our interviews with them indicate that they continue to be very involved in agency Financial Integrity Act programs. For example, they typically

- examine agency annual Financial Integrity Act work plans,
- provide technical assistance to agency personnel implementing the act,
- review risk assessment and internal control evaluation activities,
- review agency year-end Financial Integrity Act reports for accuracy and completeness, and
- report to agency heads on the results of their examination of agency implementation of the act.

The audit officials generally stated that controls had improved from 1983 through 1987 and that their agencies had implemented logical, cohesive, coordinated agencywide approaches to identifying and correcting internal control problems. They noted moderate or better top management support for a strong internal control review process and for reporting weaknesses identified and making the needed improvements. Audit officials generally rated their agency corrective actions as adequate or slightly better in solving the problems identified. However, some audit officials did not rank highly their agency's timeliness in implementing corrective actions. Furthermore, about half of the audit officials indicated their agencies needed to make changes in both their follow-up and training processes.

In addition to the chief audit officials, we also discussed the act with the chief internal control official of each agency included in our review. These officials, who are responsible for the Financial Integrity Act program within their agencies, generally felt that internal control systems had improved from 1983 through 1987. All of these individuals rated the effectiveness of agency actions to correct the material weaknesses identified as average or better. They also stated that their agencies require periodic follow-up or have a system to monitor or test component progress in taking planned corrective actions. Most of these officials also reported that their agency had some system to test or monitor those actions reported as corrected. However, about half of these officials reported they do not have a system that validates the effectiveness of the corrective action.

Federal managers generally perceive that positive impacts, such as improved internal controls and program efficiency and effectiveness, have resulted from the Federal Managers' Financial Integrity Act. However, these managers also believe improvements can be made in the areas of agency support for correcting weaknesses and in training managers to implement the act. GAO believes that opportunities for improvement exist and that agency efforts in these areas will have a positive impact on the condition of controls in the federal government.

## OMB Is Renewing Its Emphasis on Evaluating Internal Controls

In June 1989, the Director of OMB met with deputy and under secretaries of the executive agencies and asked them to prepare a new assessment of their internal control and audit follow-up processes and to report the results to him by July 23, 1989. Resulting from this effort has been an agreement between OMB and each agency as to a priority ranking of their highest risk areas. OMB expects agencies to concentrate on these areas to correct long-standing problems and will fully support and closely oversee the improvement efforts. Also, OMB is planning to increase its Financial Integrity Act staff from one to seven individuals. Continual OMB oversight and the assignment of a high priority to efforts to strengthen internal controls throughout the government are critical if we are going to see needed improvements.

On July 21, 1989, the Director of OMB met with the heads or deputies of 52 independent agencies and requested a similar report on internal controls. In addition, the President's Management by Objectives system, which is managed by OMB, includes an objective targeted at guaranteeing the effectiveness and integrity of programs and services for the public and the proper stewardship of public resources. Among the actions planned under this objective are the following:

- installation and operation of an integrated, governmentwide network of financial management systems by 1992;
- enhancement of top management's decision-making capacity by developing quality data bases which integrate program results, budget, and accounting data by 1993; and
- increase in the priority of, and policy and program level attention to, internal control and audit follow-up programs to reduce the risk of unidentified fraud and waste.

Chapter 4

# Conclusions and Recommendations

## Conclusions

Internal controls are a primary contributing factor to the efficient and economical operation of an organization's programs, whether that organization is in the public or private sector. By establishing specific operational policies and procedures and checks and balances, internal controls help provide assurance that programs accomplish their intended objectives in an efficient and effective manner with full stewardship and accountability for public funds. As such, it is incumbent upon and a direct responsibility of managers at all levels within government to ensure the existence and operation of strong internal control systems within their programs.

Almost 7 years have passed since the Financial Integrity Act became law. Governmentwide efforts to implement it have evolved over time, and agencies have reported achieving some success in identifying and correcting material internal control and accounting system weaknesses in their programs. These efforts have not, however, produced the results intended by the Congress when passing the act. The government does not currently have the internal control systems necessary to effectively operate its programs and safeguard its assets. In addition, its accounting systems are antiquated and second rate. These problems span major activities across the government and result in losses totaling billions of dollars.

Disclosures of continued widespread problems in federal programs raise serious questions about the government's commitment to strong internal control and accounting systems and to the achievement of the objectives of the act. Their existence reinforces the need for intensified actions to strengthen internal controls across the government and for comprehensive reform of the government's accounting systems. A clear need exists for changes in agency internal control and accounting system evaluation, reporting, and corrective action processes and, more importantly, for changes in the management philosophies and the general environment under which federal programs operate. The development, implementation and maintenance of a strong Financial Integrity Act program would help ensure that situations such as HUD do not occur or that the problems that do surface are less severe in terms of the dollar magnitude of the losses and the number of programs with material weaknesses. The Congress, OMB, federal agencies, GAO and the federal audit community each has a role in making the needed changes. Corrective actions must be a priority, and agencies must ensure that those actions taken are effective and get to the root cause of the problem.

## Recommendations to OMB

The Financial Integrity Act requires OMB to provide guidance for agency use in implementing the internal control evaluation, reporting, and corrective action processes required by the act. Action by the Director of OMB to personally assert leadership in this area and to reach agreement with the major agencies on the highest risk areas is an important step in addressing long-standing problems. As a next step, we recommend that OMB take prompt action to insure that agencies implement the recommendations contained in the Internal Control Interagency Coordination Council report. These recommendations include:

- linking the Financial Integrity Act internal control review and reporting process to the budget,
- identifying, in annual reports, agency actions taken to correct weaknesses, and
- validating that corrective actions are accomplished and are effective.

One Council recommendation focused on the establishment of senior level policy committees at each agency to provide oversight of the internal control evaluation and reporting processes. We recommend that OMB guidance on this point be expanded to include, as a responsibility of these committees, oversight of agency evaluations of planned, in-progress, and completed corrective actions.

To ensure the existence of a strong governmentwide Financial Integrity Act effort, we also recommend that OMB annually review the internal control and accounting system evaluation, reporting and corrective action processes in each major agency to ensure that the agencies are effectively implementing the act. We support OMB's plan to increase the number of staff assigned to Financial Integrity Act activities.

## Recommendations to the Congress

Federal agency annual Financial Integrity Act reports are an important mechanism for providing the Congress with information on serious problem areas within agency programs and with information on agency progress in correcting these problems. Additional congressional actions are needed to help ensure continued agency emphasis on the development, implementation, and maintenance of strong internal control and accounting systems. We recommend that the Congress, through its appropriation, authorization, and oversight committees, hold annual hearings on the actions of each of the 18 major federal agencies to evaluate its systems, to correct the material weaknesses identified, and to ensure that similar problems will not occur in the future. Agency Financial Integrity Act reports, plans for actions to correct material internal control and accounting system weaknesses, and financial statements provide information that congressional committees can use when planning and conducting annual oversight hearings.

Further, we continue to believe that legislation to establish a permanent financial management structure for the government is essential. We recommend that the Congress enact legislation which would, among other things:

- establish a Chief Financial Officer of the United States whose responsibilities include developing a long-range financial management improvement plan for the government,
- set up corresponding chief financial officers in each major agency, and
- require the annual preparation and audit of agency financial statements.

GAO is ready to work with the Congress in preparing this legislation.

Because of the sheer number of serious problems faced by the government, an intensified effort to correct long-standing weaknesses is needed, and urgent and effective corrective actions must be a priority. In this context, we plan to intensify our efforts in examining and evaluating internal control and accounting systems and in communicating to the agencies and the Congress the significant deficiencies and the needed short- and long-term corrective actions.

First, we plan to identify the most vulnerable federal programs or activities. Our past work has given us an understanding of the various internal control and accounting system problems facing agencies, and we have specific knowledge of many areas where fraud, waste, and mismanagement might occur. By applying selected criteria to these problem areas, we will target and prioritize specific areas for evaluation. The criteria include:

- the magnitude of the risk and the potential for the vulnerable area becoming a reality;
- our existing knowledge of the vulnerable area and the potential to clearly define the root causes of the problem;
- the probability that a meaningful solution to the problem can be developed and implemented, and
- the likelihood of achieving short-term measurable financial savings, meaning a payback for the effort and the cost of corrective measures.

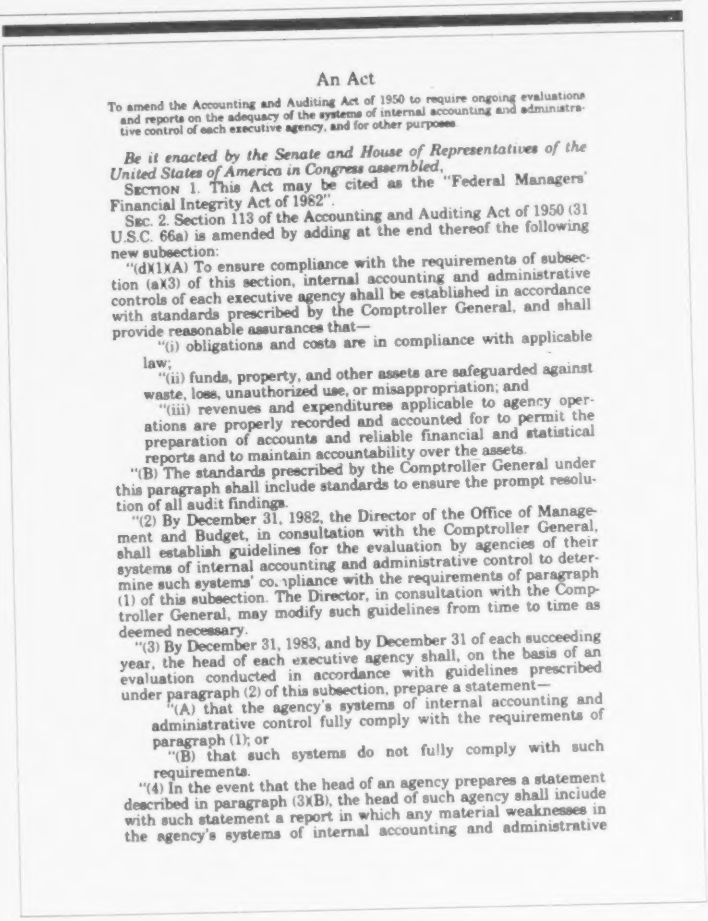
Second, in concert with the agencies and the inspectors general, we will identify actions to correct the problems. Among such actions would be to

- introduce new internal controls to help these officials deal with the problem in a systematic manner;
- develop a temporary solution to obtain immediate savings;
- implement systems changes to permanently reduce or eliminate the problem for the future; and
- have the agency head, chief financial officer, or chief internal control official closely monitor the problem area.

In some instances, legislation may be needed to help correct a problem. If, in the process of identifying corrective actions, we determine that legislative action is needed, we will recommend it.

Finally, we will undertake an ongoing monitoring role of the high risk areas in the following context. The agency chief financial officer and/or chief internal control official would have day-to-day responsibility for overseeing corrective actions with concurrent review of progress by the agency's inspector general. We will review progress reports, periodically have follow-up discussions with agency personnel and alert the Congress if the corrective action program adopted does not appear to be effective, is seriously behind schedule, needs to be revised significantly, or requires additional resources to be carried out effectively and expeditiously.

# Federal Managers' Financial Integrity Act of 1982



## An Act

**To amend the Accounting and Auditing Act of 1950 to require ongoing evaluations and reports on the adequacy of the systems of internal accounting and administrative control of each executive agency, and for other purposes.**

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

SECTION 1. This Act may be cited as the "Federal Managers' Financial Integrity Act of 1982".

SEC. 2. Section 113 of the Accounting and Auditing Act of 1950 (31 U.S.C. 66a) is amended by adding at the end thereof the following new subsection:

"(d)(1)(A) To ensure compliance with the requirements of subsection (a)(3) of this section, internal accounting and administrative controls of each executive agency shall be established in accordance with standards prescribed by the Comptroller General, and shall provide reasonable assurances that—

"(i) obligations and costs are in compliance with applicable law;

"(ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

"(iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

"(B) The standards prescribed by the Comptroller General under this paragraph shall include standards to ensure the prompt resolution of all audit findings.

"(2) By December 31, 1982, the Director of the Office of Management and Budget, in consultation with the Comptroller General, shall establish guidelines for the evaluation by agencies of their systems of internal accounting and administrative control to determine such systems' compliance with the requirements of paragraph (1) of this subsection. The Director, in consultation with the Comptroller General, may modify such guidelines from time to time as deemed necessary.

"(3) By December 31, 1983, and by December 31 of each succeeding year, the head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement—

"(A) that the agency's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1); or

"(B) that such systems do not fully comply with such requirements.

"(4) In the event that the head of an agency prepares a statement described in paragraph (3)(B), the head of such agency shall include with such statement a report in which any material weaknesses in the agency's systems of internal accounting and administrative control are identified and the plans and schedule for correcting any such weakness are described.

"(5) The statements and reports required by this subsection shall be signed by the head of each executive agency and transmitted to the President and the Congress. Such statements and reports shall also be made available to the public, except that, in the case of any such statement or report containing information which is—

"(A) specifically prohibited from disclosure by any provision of law; or

"(B) specifically required by Executive order to be kept secret in the interest of national defense or the conduct of foreign affairs,

such information shall be deleted prior to the report or statement being made available to the public.".

SEC. 3. Section 201 of the Budget and Accounting Act, 1921 (31 U.S.C. 11), is amended by adding at the end thereof the following new subsection:

"(k)(1) The President shall include in the supporting detail accompanying each Budget submitted on or after January 1, 1983, a separate statement, with respect to each department and establishment, of the amounts of appropriations requested by the President for the Office of Inspector General, if any, of each such establishment or department.

"(2) At the request of a committee of the Congress, additional information concerning the amount of appropriations originally requested by any office of Inspector General, shall be submitted to such committee.".

SEC. 4. Section 113(b) of the Accounting and Auditing Act of 1950 (31 U.S.C. 66a(b)), is amended by adding at the end thereof the following new sentence: "Each annual statement prepared pursuant to subsection (d) of this section shall include a separate report on whether the agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General under section 112 of this Act.".

Approved September 8, 1982.

# Departments and Agencies Included in the Review

Department of Agriculture
Department of Commerce
Department of Defense[1]
Department of Education
Department of Energy
Department of Health and Human Services
Department of Housing and Urban Development
Department of the Interior
Department of Justice
Department of Labor
Department of State
Department of Transportation
Department of the Treasury
Environmental Protection Agency
General Services Administration
National Aeronautics and Space Administration
Small Business Administration
Department of Veterans Affairs

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[1] For Financial Integrity Act reporting purposes, the Department of Defense (DOD) reviews the reports prepared by its component organizations (i.e., Army, Navy, Air Force, Defense Intelligence Agency, Defense Communications Agency, and other offices) and prepares a single Financial Integrity Act report for transmittal to the President and the Congress.

For the questionnaire phase of this assignment, we obtained DOD information from component managers and agency senior executives in Army, Navy, Air Force, and the Defense Logistics Agency (DLA). For chief control official interview purposes, we added the Office of the Secretary of Defense to the list of DOD organizations. We used the same universe for the inspector general (IG) or audit official interviews except we excluded DLA, which does not have an auditor general or IG position comparable to those in the other DOD organizations.

# Technical Description of GAO's Survey and Sampling Methodology

In this appendix we discuss the sampling procedures used in our survey. We address pretesting the instruments, selecting the universe and sample size, and validating the results. The instruments we used were: (1) a component manager questionnaire, (2) a senior agency executive questionnaire, and (3) standardized interview documents for meetings with agency inspectors general and chief internal control officials.

## Pretesting

The purpose of our pretest was to ensure that each question had a common or uniform meaning, that the instrument was clear and easy to understand, and that the instrument elicited standardized responses. Except for the inspector general and chief internal control official universe, we did not include the responses to the pretest in our results. We included their responses because of the small size of these universes and potential difficulties in scheduling second interviews with these officials.

The pretest of the questionnaire consisted of two phases. In phase one, we asked several component managers and senior executives to complete the questionnaire as if they had received it in the mail. GAO observers noted the length of time it took to complete the questionnaire and any difficulties encountered. In phase two, we discussed each question and the overall questionnaire content with the manager or senior executive. We also discussed the possible responses that their colleagues might make to the questions in order to determine whether we should revise any of them.

We did not conduct a similar pretest of the standardized interview document. Rather, we used the responses of the first three inspector general and chief internal control official interviews as a pretest. During the interview, we noted any difficulties experienced by the individual being interviewed and made adjustments as we deemed necessary. We designed the interview questions to be consistent with the questions in the questionnaires.

## Selecting the Universe and Sample Size

To determine the universe for the component manager questionnaire, we used information that each of the 17 civilian agencies reported in the Management Control Plan contained in their annual Federal Managers' Financial Integrity Act report. For the defense agencies, we used information provided by each organizational unit's (i.e., Army, Navy, etc.) internal control coordinator. We identified a total of 23,758 components in our universe of agencies.

We stratified the civil agency universe, by agency, into two groups: (1) components that had conducted an internal control review (ICR) or an alternative internal control review (AICR) of their systems and (2) components that had not conducted such reviews. We then calculated a sample size for each agency.

We did not stratify the defense agencies into groups because we were unable to identify those components that had conducted an ICR or AICR. Rather, we considered each service and the Defense Logistics Agency to be a separate agency strata.

The outcome of this process resulted in a component manager sample size of 1,070, comprised of 886 civilian and 184 military components. Of the 886 civilian components, 370 conducted ICRs and 516 did not. During the verification process, we determined that nine civilian components did not meet our selection criteria, so we reduced our sample size to 1061.

The universe for the senior agency executive questionnaire consisted of all of the assistant secretaries or equivalent level officials identified by each agency's internal control coordinator. We excluded any senior executive who was also the agency's chief internal control official. This process identified 671 executives, but, upon further inquiry, we excluded three from the universe because they did not meet our criteria. The final senior executive universe consisted of 668 executives—509 from civilian agencies and 159 from Defense agencies. We sent a questionnaire to each of these individuals.

We conducted standardized interviews with 21 inspectors general, auditors general, or internal auditors, and 22 assistant secretaries or equivalent level officials. In some cases, the agency's chief internal control official also was an assistant secretary or equivalent level official. (See appendix II for an agency listing.)

## Validating the Survey Results

We used the interviews with the inspectors general and chief internal control officials to validate the responses obtained from the questionnaires. Data were also validated by a cross comparison between the senior agency executive and component manager questionnaires. As an additional validation procedure, we tested 59 hypotheses and performance variables and found consistency in all cases. In addition, as mentioned earlier, we conducted pretests to ensure the validity of the survey instruments. Since the data collection methods involve self-reporting by the subject populations, we expect adverse findings to be somewhat underreported.

## Calculating the Sample Response Rates

Our effective (real) sample size for the component manager questionnaires was 1,061. We received 857 responses to our questionnaire for a response rate of 82 percent. We found that 704, or 80 percent, of the 877 civilian managers included in our sample responded. There was a similarly high response rate of 83 percent for the 153 defense managers who returned the questionnaire.

For the senior agency executive questionnaire, we had an effective or real universe of 668 and a response rate of 81 percent. Civilian executives submitted responses to 418, or 82 percent, of the 509 questionnaires mailed. We found 126, or 79 percent, of the 159 defense managers surveyed responded.

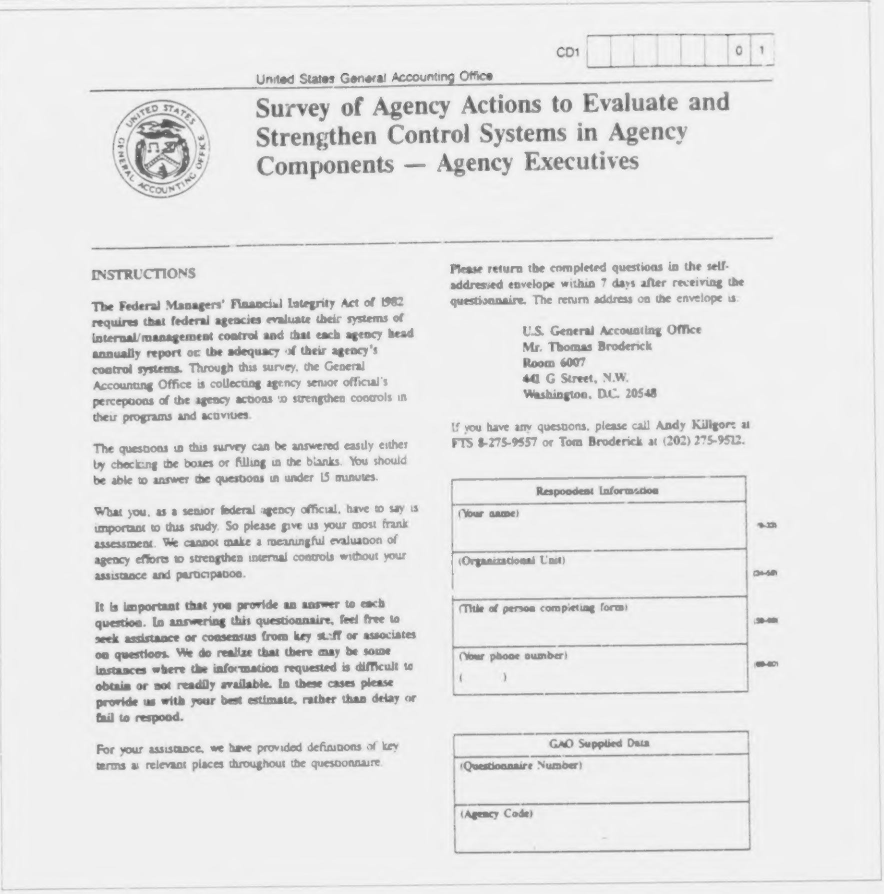
## Calculating the Nonresponse Rate and Sampling Error

We estimate, based on the responses received from the component manager questionnaire, that the overall response rate, when projected to the universe, is 78 percent. Therefore, if we had mailed questionnaires to the entire adjusted universe, we would have received 18,319 responses, from the universe of 23,758 (plus or minus 888 responses). Since we did not obtain a 100 percent response rate, our maximum sampling error increased to about plus or minus 5 percent as compared to the originally planned 4.4 percent rate.

# Summary of Questionnaire Results

This appendix shows how the component managers and agency executives that responded to the survey answered each question. The percentage to the right of the question alternatives shows the percent or proportion of managers answering the question that chose that particular alternative. In some cases, questions were preceded by a filter question that screened out a proportion or percent of the population. The reader is cautioned to account for these filter questions when comparing the results of responses to specific questions back to the statistics cited in the body of the report. Because there are instances where the respondent could choose more than one alternative, the sum of the percentages for each alternative need not necessarily total 100 percent. Also, in questions where the respondent was asked to write in an amount (e.g., question nine of the component questionnaire), the average or mean of reported amounts is presented. In matrix-type questions, the percentage of respondents choosing a particular alternative are typed within the appropriate matrix box or row-column space.

Percentages may not total 100 due to rounding and may not, in some cases, appear to match those in the text. This is due to calculations made with the raw data to provide more meaningful information in the report. An example is calculating the percent of the entire population as opposed to the percent of the filtered respondents. The "missing" data category represents a "no response" to an individual question in this questionnaire. These values were considered as nonresponses and were not calculated into our evaluation. In most instances, this includes zero to 5 percent of the responses.



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United States General Accounting Office

# Survey of Agency Actions to Evaluate and Strengthen Control Systems in Agency Components — Agency Executives

## INSTRUCTIONS

**The Federal Managers' Financial Integrity Act of 1982 requires that federal agencies evaluate their systems of internal/management control and that each agency head annually report on the adequacy of their agency's control systems.** Through this survey, the General Accounting Office is collecting agency senior official's perceptions of the agency actions to strengthen controls in their programs and activities.

The questions in this survey can be answered easily either by checking the boxes or filling in the blanks. You should be able to answer the questions in under 15 minutes.

What you, as a senior federal agency official, have to say is important to this study. So please give us your most frank assessment. We cannot make a meaningful evaluation of agency efforts to strengthen internal controls without your assistance and participation.

**It is important that you provide an answer to each question. In answering this questionnaire, feel free to seek assistance or consensus from key staff or associates on questions. We do realize that there may be some instances where the information requested is difficult to obtain or not readily available. In these cases please provide us with your best estimate, rather than delay or fail to respond.**

For your assistance, we have provided definitions of key terms at relevant places throughout the questionnaire.

**Please return the completed questions in the self-addressed envelope within 7 days after receiving the questionnaire.** The return address on the envelope is:

**U.S. General Accounting Office**
**Mr. Thomas Broderick**
**Room 6007**
**441 G Street, N.W.**
**Washington, D.C. 20548**

If you have any questions, please call **Andy Killgore** at **FTS 8-275-9557** or **Tom Broderick** at (202) 275-9512.

| Respondent Information | |
|---|---|
| (Your name) | (9-33) |
| (Organizational Unit) | (34-58) |
| (Title of person completing form) | [illegible] |
| (Your phone number)<br>(     ) | [illegible] |

| GAO Supplied Data |
|---|
| (Questionnaire Number) |
| (Agency Code) |

CD2 ☐☐☐☐☐☐ 0 2

## I. REVIEWS OF MANAGEMENT CONTROL SYSTEMS

**In this section, we are interested in obtaining your perceptions of the effectiveness of the reviews of agency management control systems within your organizational unit.**

For purposes of this questionnaire, a **management control system** is the organization structure, operating procedures, and administrative practices adopted by all levels of management to provide reasonable assurance that programs and administrative activities are effectively carried out. Included within this definition are *both management and accounting control systems.*

**Reviews of management control systems** (i.e., an **internal control review** or **alternative internal control review**) are detailed evaluations of program or administrative activity control systems to determine whether adequate safeguards exist to reasonably ensure compliance with applicable laws; accountability over assets; protection against waste, loss, unauthorized use, and misappropriation; and preparation and maintenance of reliable financial and statistical reports.

1. To what extent, if at all, have reviews of management control systems been completed in your organizational unit within the past 3 years? (Check one.)

1. ☐ To a very great extent 26
2. ☐ To a great extent 44
3. ☐ To a moderate extent 19
4. ☐ To some extent 5
5. ☐ To little or no extent 1
6. ☐ Not applicable — no reviews have been completed — Go to question 4 3

Missing 1

PLEASE GO TO NEXT PAGE

For purposes of this questionnaire, a **material management control weakness** is a weakness that would significantly impair the fulfillment of an organizational unit's mission; deprive the public of needed services; violate statutory or regulatory requirements; significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or result in a conflict of interest.

For purposes of this questionnaire, a **nonmaterial weakness** is any weakness that is not sufficient to impair significantly the fulfillment of an organization unit's mission, etc.

2. To what extent, if at all, have the reviews of **management control systems** conducted in your organizational unit identified **material** and/or **nonmaterial management control system weaknesses**? **(Enter response number in the space provided.)**

RESPONSE SCALE

| | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 4 | 3 |
| 2 = To a great extent | 11 | 17 |
| 3 = To a moderate extent | 15 | 30 |
| 4 = To some extent | 24 | 29 |
| 5 = To little or no extent | 46 | 21 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ________ | (10) |
| 2. Nonmaterial Weakness | ________ | (11) |

3. To what extent, if at all, were you (or other senior agency officials) **aware of these management control weaknesses** before the **reviews of management control systems** in your organizational unit? **(Enter response number in the space provided.)**

RESPONSE SCALE

| | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 9 | 6 |
| 2 = To a great extent | 21 | 17 |
| 3 = To a moderate extent | 15 | 27 |
| 4 = To some extent | 14 | 27 |
| 5 = To little or no extent | 10 | 12 |
| 6 = No weaknesses have been identified | 30 | 11 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1 Material Weakness | ________ | (12) |
| 2 Nonmaterial Weakness | ________ | (13) |

PLEASE GO TO NEXT PAGE

## II. ACTIONS TO CORRECT MANAGEMENT CONTROL SYSTEMS

**In this section, we are interested in obtaining your perceptions of the effectiveness of agency efforts to eliminate management control system weaknesses and the level of agency support for improvement activities.**

4. To what extent, if at all, does your agency support actions to correct management control system weaknesses? (Check one.)

1. ☐ To a very great extent 49
2. ☐ To a great extent 41
3. ☐ To a moderate extent 8
4. ☐ To some extent 2
5. ☐ To little or no extent 1
6. ☐ Unknown 1

5. How, if at all, has your agency demonstrated its support for correcting management control system weaknesses in your organizational unit? (Check all that apply.)

1. ☐ Requested/budgeted increased funds to make the needed changes 31
2. ☐ Provided funds to make the needed changes 37
3. ☐ Increased staffing to implement and maintain improved management control systems 32
4. ☐ Memo/letter from agency head discussing the importance of agency efforts to strengthen management controls 67
5. ☐ Direct high-level agency management involvement in determining corrective actions needed 63
6. ☐ Direct high-level agency management involvement in implementing corrective actions identified 59
7. ☐ Agency management involved in follow-up procedures to determine the timeliness and effectiveness of corrective actions 71
8. ☐ Requires training in management control system reviews and methods to correct weaknesses identified 33
9. ☐ Other (Specify.) ______ 13
10. ☐ Not applicable – organizational unit has no management control systems needing corrective actions 9
11. ☐ Agency shows no support for correcting management control system weaknesses 1

PLEASE GO TO NEXT PAGE

6. What agency actions, if any, indicate your agency's lack of support for correcting **management control system weaknesses** in your organizational unit?
**(Check all that apply.)**

| | | |
|---|---|---|
| 1. ☐ Verbal support for improvements only | (37-38) | 2 |
| 2. ☐ Inadequate increase in funds to make needed changes | (39-40) | 6 |
| 3. ☐ Inadequate increase in staff to make needed improvements | (41-42) | 11 |
| 4. ☐ Agency priorities higher in improving control systems in other areas or activities within the agency | (43-44) | 5 |
| 5. ☐ Agency appears willing to accept the risk of fraud, waste, abuse, or mismanagement that exists under the current **management control systems** | (45-46) | 0 |
| 6. ☐ Agency omits important **management control systems** from the evaluation process | (47-48) | 2 |
| 7. ☐ Lack of meaningful training | (49-50) | 5 |
| 8. ☐ Other (Specify.) ________________ | (51-52) | 3 |
| 9. ☐ None of the above — agency's actions support corrective actions | (53-54) | 71 |
| 10. ☐ Not applicable — organizational unit has no material weaknesses | (55-56) | 14 |

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CD3 ☐☐☐☐☐☐ 0 3

7. How, if at all, have you demonstrated your support for correcting **management control system weaknesses** in your organizational unit? (**Check all that apply.**)

| | | | |
|---|---|---|---|
| 1. ☐ | Programs and/or activities within my organizational unit have no **management control system weaknesses** | (57-58) | 14 |
| 2. ☐ | Requested funds to make needed changes | (59-60) | 26 |
| 3. ☐ | Increased funds to make the needed changes | (61-62) | 24 |
| 4. ☐ | Requested an increase in staffing to implement and maintain improved **management control systems** | (63-64) | 26 |
| 5. ☐ | Increased staffing to implement and maintain improved **management control systems** | (65-66) | 27 |
| 6. ☐ | Distributed memo/letter discussing the importance of agency efforts to strengthen internal controls | (67-68) | 50 |
| 7. ☐ | Direct involvement in determining corrective actions needed | (69-70) | 61 |
| 8. ☐ | Direct involvement in implementing corrective actions identified | (71-72) | 56 |
| 9. ☐ | Direct involvement in follow-up procedures to determine the timeliness and effectiveness of corrective actions | (73-74) | 61 |
| 10. ☐ | Required that personnel take training in **management control system evaluations** and methods to improve weaknesses identified | (75-76) | 31 |
| 11. ☐ | Other (Specify.) ______________ | (77-78) | 11 |
| 12. ☐ | I have not demonstrated any support | (79-80) | 0 |

8. How adequate or inadequate was your agency's discussion (in its annual report to the President and the Congress — as required by the **Federal Managers' Financial Integrity Act**) of the **material management control weaknesses** identified in your organizational unit? (**Check one.**) (9)

| | | |
|---|---|---|
| 1. ☐ | Very adequate | 32 |
| 2. ☐ | Adequate | 31 |
| 3. ☐ | Marginally adequate | 2 |
| 4. ☐ | Inadequate | 0 |
| 5. ☐ | Very inadequate | 0 |
| 6. ☐ | No basis to judge — did not see the report | 12 |
| 7. ☐ | Not applicable — no material weaknesses were identified | 23 |

PLEASE GO TO NEXT PAGE

9. How adequate or inadequate was your opportunity for input in your agency's report to the President and the Congress as required by the **Federal Managers' Financial Integrity Act?**
**(Check one.)**

| | |
|---|---|
| 1. ☐ Very adequate | 45 |
| 2. ☐ Adequate | 36 |
| 3. ☐ Marginally adequate | 2 |
| 4. ☐ Inadequate | 2 |
| 5. ☐ Very inadequate | 2 |
| 6. ☐ Not applicable — no weaknesses in my unit | 12 |
| Missing | 1 |

10. To what extent, if at all, have actions been implemented to correct **management control system weaknesses** identified in your organizational unit, by whatever means, during the past 3 years?
**(Enter response number in the space provided.)**

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 23 | 19 |
| 2 = To a great extent | 28 | 40 |
| 3 = To a moderate extent | 9 | 16 |
| 4 = To some extent | 3 | 6 |
| 5 = To little or no extent | 0 | 1 |
| 6 = This type weakness not identified in my unit | 33 | 13 |
| 7 = No basis to judge | 2 | 3 |
| Missing | 2 | 2 |

| ACTION | RESPONSE NUMBER |
|---|---|
| 1. Material Weakness | ____________ |
| 2. Nonmaterial Weakness | ____________ |

11. To what extent, if at all, have the corrective actions taken eliminated the **management control system weaknesses** identified in your organizational unit's programs and/or activities, by whatever means, during the past 3 years? **(Enter response number in the space provided.)**

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 15 | 13 |
| 2 = To a great extent | 28 | 41 |
| 3 = To a moderate extent | 14 | 20 |
| 4 = To some extent | 5 | 6 |
| 5 = To little or no extent | 1 | 1 |
| 6 = This type weakness not identified in my unit | 33 | 13 |
| 7 = No basis to judge | 3 | 4 |
| Missing | 2 | 1 |

| ACTION | RESPONSE NUMBER |
|---|---|
| 1. Material Weakness | ____________ |
| 2. Nonmaterial Weakness | ____________ |

12. To what extent, if at all, has your agency followed up to determine that planned corrective actions were taken on material weaknesses identified? **(Enter response number in the space provided.)**

| RESPONSE SCALE | |
|---|---|
| 1 = Not applicable — no weaknesses identified | 22 |
| 2 = To a very great extent | 30 |
| 3 = To a great extent | 29 |
| 4 = To a moderate extent | 9 |
| 5 = To some extent | 4 |
| 6 = To little or no extent | 2 |
| 7 = No basis to judge | 5 |

| ACTION | RESPONSE NUMBER |
|---|---|
| 1. Corrective Action | ____________ |

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## III. COST EFFECTIVENESS OF PROCESS OF EVALUATING AND STRENGTHENING MANAGEMENT CONTROL SYSTEMS

**In this section, we are interested in collecting agency officials' perspectives of the costs and benefits resulting from agency efforts to evaluate and strengthen the management control systems within its programs, activities, organizations, and functions.**

13. **Based on your best estimate, to what extent, if at all, did the improvements made and benefits obtained, justify the costs incurred (consider all costs incurred – personnel, paperwork, etc.) to review management control systems in your organizational unit?** (**Check one.**)

| | |
|---|---|
| 1. ☐ To a very great extent – Go to question 15. | 8 |
| 2. ☐ To a great extent – Go to question 15. | 23 |
| 3. ☐ To a moderate extent – Go to question 15. | 25 |
| 4. ☐ To some extent – Go to question 14. | 17 |
| 5. ☐ To little or no extent – Go to question 14. | 12 |
| 6. ☐ Unknown – cost and other relevant data not available for analysis purposes – Go to question 15. | 16 |

14. **Why did the improvements not justify the cost? (Check all that apply.)**

| | |
|---|---|
| 1. ☐ Work required participation of too many staff | 40 |
| 2. ☐ Length of time (calendar days) excessive | 26 |
| 3. ☐ Work required too much paperwork (documentation and reports) | 65 |
| 4. ☐ Control systems considered adequate before the process | 51 |
| 5. ☐ Process did not identify any weaknesses not already known | 49 |
| 6. ☐ Duplicated review efforts already conducted by other organizations (i.e., Inspector General, GAO, etc.) | 48 |
| 7. ☐ Other (Specify.) ____________ | 12 |

PLEASE GO TO NEXT PAGE

15. What, if any, are the most significant benefits resulting from the agency's action to strengthen the management control systems in the programs and/or activities in your organizational unit? (Check all that apply.)

1. ☐ Helped me better establish priorities within the organizational unit (24-25) 25
2. ☐ Identified activities/functions which caused inefficient or ineffective operations (26-27) 39
3. ☐ Helped identify actions that could improve the efficiency and effectiveness of the organizational unit (28-29) 58
4. ☐ Better control over operations (30-31) 48
5. ☐ Better allocation of staff resources (32-33) 22
6. ☐ More accurate and timely information provided by ADP systems (34-35) 19
7. ☐ More accurate and timely information provided by accounting/financial management systems (36-37) 26
8. ☐ More effective or better controlled ADP or accounting/financial management systems were developed and implemented (38-39) 26
9. ☐ Organizational unit personnel more aware of importance of strong management control systems (40-41) 67
10. ☐ Identified material problems for my and other senior management officials consideration (42-43) 30
11. ☐ Organizational unit personnel actively attempt to identify and improve management control system weaknesses (44-45) 39
12. ☐ Improved efficiency/effectiveness in accomplishing the agency component's mission (46-47) 37
13. ☐ Focused attention on solving long-standing problems (48-49) 34
14. ☐ Other (Specify.) ______________ (50-51) 5
15. ☐ No significant benefits observed (52-53) 7

PLEASE GO TO NEXT PAGE

16. What, if any, are the most significant problems in your organizational unit as a result of your agency's actions to strengthen the **management control systems** within its programs, activities, organizations, and functions? (**Check all that apply.**)

1. ☐ Program slippage (54) 6
2. ☐ **Management control system** improvement priorities inconsistent with meeting program objectives (55) 9
3. ☐ Control procedures too time consuming/ burdensome (56) 18
4. ☐ Other (Specify.) ______ (57) 9
5. ☐ No significant problems observed (58) 67

17. To what extent, if at all, have **management controls** in the programs and/or activities in your organizational unit improved as a result of the **Federal Managers' Financial Integrity Act**? (**Check one.**) (59)

1. ☐ To a very great extent 2
2. ☐ To a great extent 20
3. ☐ To a moderate extent 30
4. ☐ To some extent 24
5. ☐ To little or no extent 13
6. ☐ No basis to judge 11

18. How successful or unsuccessful has your agency's implementation of the **Federal Managers' Financial Integrity Act** program been in your organizational unit? (**Check one.**) (60)

1. ☐ Very successful 19
2. ☐ Successful 58
3. ☐ Marginally successful 11
4. ☐ Unsuccessful 1
5. ☐ Very unsuccessful 0
6. ☐ No basis to judge 12

PLEASE GO TO NEXT PAGE

CD4 ☐☐☐☐☐☐ 0 4

## IV. ADDITIONAL COMMENTS

19. If you have any additional comments on any of the items in this questionnaire or related topics, please express your views in the space below. **(Attach additional sheets, if necessary.) Thank you for your cooperation.** (0-05)

| | |
|---|---|
| No Comments | 77 |
| Comments | 23 |

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United States General Accounting Office

# Survey of Agency Efforts To Evaluate and Strengthen Control Systems in Agency Components

INSTRUCTIONS

**The Federal Managers' Financial Integrity Act of 1982 requires that federal agencies evaluate their systems of internal/management control and that each agency head annually report on the adequacy of their agency's control systems.** Through this survey, the General Accounting Office is collecting selected historical information on, and agency managers' perceptions of, agency actions to strengthen controls in their programs and activities.

The questions in this survey can be answered easily either by checking the boxes or filling in the blanks. You can answer the questions in about 30 minutes.

What you, as the manager of a program and/or activity have to say is important to this study. The "Respondent Information" identifies the program and/or activity for which we wish to obtain information. So please give us your most frank assessment. We cannot make a meaningful evaluation of agency efforts to strengthen controls without your assistance and participation.

**It is important that you provide an answer to each question. In answering this questionnaire, feel free to seek assistance or consensus from key staff or associates on questions. This may be particularly true in answering questions concerning the performance and results of risk assessments and management control evaluations. We do realize that there may be some instances where the information requested is difficult to obtain or not readily available. In these cases please provide us with your best estimate, rather than delay or fail to respond.**

For your assistance, we have provided definitions of key terms at relevant places throughout the questionnaire.

**Please return the completed form in the self-addressed envelope within 7 days after receiving the questionnaire.** The return address on the envelope is:

**U.S. General Accounting Office
Mr. Thomas Broderick
Room 6007
441 G Street, N.W.
Washington, D.C. 20548**

If you have any questions, please call **Andy Killgore** at FTS **8-275-9557** or **Tom Broderick** at (202) 275-9512.

| Respondent Information | |
|---|---|
| (Your name) | (9-33) |
| (Program and/or activity) | (34-48) |
| (Title of person completing form) | (50-59) |
| (Your phone number)<br>(     ) | (60-69) |

| GAO Supplied Data |
|---|
| (Questionnaire number) |
| (Agency code) |
| (Recent risk assessment rating) |

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## I. GENERAL INFORMATION

**We are interested in collecting general information on the program and/or activity identified earlier.**

1. How long have you been responsible for the program and/or activity identified earlier in the questionnaire? **(Check one.)**

| | |
|---|---|
| 1. ☐ Under 1 year | 15 |
| 2. ☐ From 1 to under 2 years | 18 |
| 3. ☐ From 2 to under 5 years | 31 |
| 4. ☐ 5 years or more | 37 |

2. As of October 1, 1987, how many full-time staff worked in the program and/or activity? **(Check one.)** (10)

| | |
|---|---|
| 1. ☐ None | 8 |
| 2. ☐ From 1 to 10 | 38 |
| 3. ☐ From 11 to 25 | 17 |
| 4. ☐ From 26 to 50 | 16 |
| 5. ☐ From 51 to 100 | 11 |
| 6. ☐ 101 or more | 9 |

3. What was the fiscal year 1987 dollar budget of the program and/or activity? **(Check one.)** (11)

| | |
|---|---|
| 1. ☐ Under $500,000 | 26 |
| 2. ☐ From $500,000 to under $1,000,000 | 8 |
| 3. ☐ From $1,000,000 to under $5,000,000 | 16 |
| 4. ☐ From $5,000,000 to under $10,000,000 | 3 |
| 5. ☐ From $10,000,000 to under $50,000,000 | 8 |
| 6. ☐ Over $50,000,000 | 12 |
| 7. ☐ Unknown | 25 |
| Missing | 2 |

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4. What is the primary function performed by the program and/or activity? (**Check one.**) (12-13)

| | | |
|---|---|---|
| 1. ☐ ADP — Go to question 5 | 8 | |
| 2. ☐ Program management | 37 | GO TO QUESTION 6 |
| 3. ☐ Procurement | 11 | |
| 4. ☐ Grant management | 2 | |
| 5. ☐ Personnel and organizational management | 12 | |
| 6. ☐ Payment systems and cash management | 5 | |
| 7. ☐ Loan management and debt collection | 0 | |
| 8. ☐ Property and inventory management | 5 | |
| 9. ☐ Accounting or financial management | 5 | |
| 10. ☐ Other (Specify.) | 16 | |

Go to question 6.

5. Which ADP functions is the program and/or activity responsible for performing in support of other programs or activities? (**Check all that apply.**)

| | | |
|---|---|---|
| 1. ☐ Procurement | 20 | (14) |
| 2. ☐ Security | 39 | (15) |
| 3. ☐ Data processing operations | 58 | (16) |
| 4. ☐ Systems design, development, and/or maintenance | 59 | (17) |
| 5. ☐ Other (Specify.) | 15 | (18) |

6. In carrying out its mission, to what extent, if at all, does the program and/or activity use data generated from ADP systems? (**Check one.**) (19)

| | |
|---|---|
| 1. ☐ To a very great extent | 23 |
| 2. ☐ To a great extent | 25 |
| 3. ☐ To a moderate extent | 20 |
| 4. ☐ To some extent | 15 |
| 5. ☐ To little or no extent | 13 |
| 6. ☐ No basis to judge | 4 |

## II. AGENCY EVALUATIONS OF MANAGEMENT CONTROL SYSTEMS

**We are interested in collecting historical information and program and/or activity managers' perceptions of the risk assessment and management control evaluation phases of the agency's program for strengthening its management control systems.**

For purposes of this questionnaire, an **internal/management control system** is the organizational structure, operating procedures, and administrative practices adopted by all levels of management to provide reasonable assurance that programs and administrative activities are effectively carried out. Included within this definition are *both management and accounting control systems*.

7. Before 1983, to what extent, if at all, did your agency have a process for evaluating the **management control systems** in its programs and/or activities? (Check one.)

| | | |
|---|---|---|
| 1. ☐ To a very great extent | 6 | CONTINUE |
| 2. ☐ To a great extent | 17 | |
| 3. ☐ To a moderate extent | 27 | |
| 4. ☐ To some extent | 18 | |
| 5. ☐ To little or no extent<br>Go to question 9. | 7 | |
| 6. ☐ Unknown — Go to question 9. | 25 | |
| Missing | 1 | |

8. How adequate or inadequate was the process that existed before 1983 for evaluating the program's and/or activity's **management control systems**? (Check one.)

| | |
|---|---|
| 1. ☐ More than adequate | 16 |
| 2. ☐ Adequate | 50 |
| 3. ☐ Marginally adequate | 22 |
| 4. ☐ Inadequate | 5 |
| 5. ☐ Very inadequate | 0 |
| 6. ☐ No basis to judge | 6 |

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## III. ASSESSMENT OF RISK IN THE PROGRAM AND/OR ACTIVITY

**A key element in the process of examining agency management control systems is a determination of those programs and/or activities whose functions are most vulnerable to error or improper acts. We are interested in collecting information on the risk assessments performed on these programs and/or activities and on your perceptions of the assessments.**

> For purposes of this questionnaire, a **risk assessment** (also referred to as **vulnerability assessment** and/or **alternate procedures**) is a documented review by management of a program and/or activity's susceptibility to waste, loss, unauthorized use, or misappropriations.

9. How many **risk assessments** within your Department (i.e., Energy, Interior, etc.) did you conduct or participate in each year since 1983? **(Enter number.)**

| YEAR | NUMBER | % -0- | % 1 or More | |
|---|---|---|---|---|
| 1. 1983 | ______ | 63 | 37 | (22-26) |
| 2. 1984 | ______ | 57 | 43 | (27-31) |
| 3. 1985 | ______ | 53 | 47 | (32-36) |
| 4. 1986 | ______ | 44 | 56 | (37-41) |
| 5. 1987 | ______ | 41 | 59 | (42-46) |

10. Indicate the years in which a **risk assessment** was conducted on the program and/or activity identified earlier. **(Check all that apply.)**

| | | | |
|---|---|---|---|
| 1. ☐ None — Go to question 16. | | 22 | (47) |
| 2. ☐ 1983 | CONTINUE | 35 | (48) |
| 3. ☐ 1984 | | 45 | (49) |
| 4. ☐ 1985 | | 46 | (50) |
| 5. ☐ 1986 | | 58 | (51) |
| 6. ☐ 1987 | | 58 | (52) |

11. Who performed the **most recent risk assessment** of the program and/or activity? **(Check all that apply.)**

| | | |
|---|---|---|
| 1. ☐ Me (or the prior program and/or activity manager) or a member of my (or the prior manager's) staff | 76 | (53) |
| 2. ☐ Agency Inspector General or audit organization personnel | 9 | (54) |
| 3. ☐ Other agency management officials/personnel | 37 | (55) |
| 4. ☐ Consultant/contractor | 2 | (56) |
| 5. ☐ Other (Specify.) ______ | 3 | (57) |
| 6. ☐ Unknown | 0 | (58) |

12. How adequate or inadequate were the results of the **most recent risk assessment** of the program and/or activity in reflecting its susceptibility to waste, loss, unauthorized use, or misappropriations? (**Check one.**)

- 1. ☐ More than adequate — Go to question 14. 35
- 2. ☐ Adequate — Go to question 14. 58
- 3. ☐ Marginally adequate — CONTINUE 4
- 4. ☐ Inadequate — CONTINUE 1
- 5. ☐ Very inadequate — CONTINUE 0
- 6. ☐ Unknown — Go to question 14. 2

13. If less than "adequate," why? (**Check all that apply.**)

- 1. ☐ Guidance for performing **risk assessments** is vague and/or procedures are poorly defined 34
- 2. ☐ Agency's evaluation process is too judgmental 40
- 3. ☐ Agency's evaluation process is based on factors that are not relevant to **susceptibility** 33
- 4. ☐ Relevant **management control systems** are omitted from the **assessments** 21
- 5. ☐ Other (Specify.) ____________ 15

For purposes of this questionnaire, a **material internal/management control weakness** is a weakness that would significantly impair the fulfillment of a program and/or activity's mission, deprive the public of needed services; violate statutory or regulatory requirements; significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or result in a conflict of interest.

For purposes of this questionnaire, a **nonmaterial weakness** is any weakness that is not sufficient to impair significantly the fulfillment of a program and/or activity's mission, etc.

14. To what extent, if any, has the **risk assessment** work conducted on the program and/or activity identified material and/or nonmaterial **management control system weaknesses**? (**Enter response number in the space provided.**)

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 2 | 2 |
| 2 = To a great extent | 7 | 8 |
| 3 = To a moderate extent | 7 | 9 |
| 4 = To some extent | 7 | 19 |
| 5 = To little or no extent | 44 | 33 |
| 6 = No basis to judge | 8 | 6 |
| N/A Missing | 25 | 23 |

| ACTION | RESPONSE NUMBER |
|---|---|
| 1. Material Weakness | ________ |
| 2. Nonmaterial Weakness | ________ |

15. To what extent, if at all, were you (or other program and/or activity managers) aware of these weaknesses before the risk assessment(s) were conducted? (**Enter response number in the space provided.**)

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 7 | 7 |
| 2 = To a great extent | 14 | 15 |
| 3 = To a moderate extent | 7 | 9 |
| 4 = To some extent | 9 | 16 |
| 5 = To little or no extent | 7 | 8 |
| 6 = No basis to judge | 6 | 4 |
| 7 = No material/nonmaterial weaknesses identified | 27 | 18 |
| N/A/Missing | 25 | 23 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ________ | (67) |
| 2. Nonmaterial Weakness | ________ | (68) |

16. Does your agency offer internal and/or external training or other direct assistance in conducting risk assessments? (**Check one.**) (69)

1. ☐ Yes — Continue 73
2. ☐ No — Go to question 21. 27

17. Have you received internal and/or external training in understanding and conducting risk assessments? (**Check one.**) (70)

1. ☐ Yes — Continue 75
2. ☐ No — Go to question 21. 25

18. What types of training have you had? (**Check all that apply.**)

1. ☐ Internal classroom 53 (71)
2. ☐ External classroom 13 (72)
3. ☐ Private consultant 8 (73)
4. ☐ On the job training 69 (74)
5. ☐ Other (Specify.) 11 (75)

19. How adequate or inadequate is the current internal and/or external training in meeting your needs in understanding and performing risk assessments of programs and/or activities? (**Check one.**) (76)

1. ☐ More than adequate 25
2. ☐ Adequate 62
3. ☐ Marginally adequate 12
4. ☐ Inadequate 1
5. ☐ Very inadequate 0

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20. In what areas, if any, does your agency's risk assessment training need improvements? (Check all that apply.)

| | | |
|---|---|---|
| 1. ☐ No improvements needed | (9) | 51 |
| 2. ☐ Defining terms | (10) | 9 |
| 3. ☐ Defining the purpose and objectives of the assessments | (11) | 16 |
| 4. ☐ Identifying the procedures required to perform a risk assessment | (12) | 17 |
| 5. ☐ Explaining how to analyze and evaluate the results of the risk assessment | (13) | 21 |
| 6. ☐ Identifying the documentation needed to support the risk assessment conclusions | (14) | 16 |
| 7. ☐ Identifying the methodology to be used in assessing risk in ADP systems | (15) | 15 |
| 8. ☐ Identifying methodology to be used in assessing risk in accounting/financial management systems | (16) | 11 |
| 9. ☐ Other (Specify.) ________________ | (17) | 6 |

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## IV. EVALUATION OF MANAGEMENT CONTROL SYSTEMS IN THE PROGRAM AND/OR ACTIVITY

**The principal methodologies used to examine management control systems are the management control evaluations or alternative management control evaluations. We are interested in collecting information on these evaluations and your perceptions on their effectiveness as evaluation tools.**

> As used in this questionnaire, an **internal/management control evaluation** (i.e., an **internal control review** or **alternative internal control review**) is a detailed evaluation of a program or administrative activity to determine whether adequate safeguards exist to reasonably ensure compliance with applicable laws; protection against waste, loss, unauthorized use, and misappropriation; and preparation and maintenance of reliable financial and statistical reports and accountability over assets.

21. How many **management control evaluations** within your Department (i.e., Energy, Interior, etc.) did you conduct or participate in since 1983? (**Enter number in spaces provided.**)

| YEAR | NUMBER | %<br>-0- | %<br>1 or More | |
|---|---|---|---|---|
| 1. 1983 | ______ | 64 | 36 | (18-22) |
| 2. 1984 | ______ | 59 | 41 | (23-27) |
| 3. 1985 | ______ | 50 | 50 | (28-32) |
| 4. 1986 | ______ | 43 | 57 | (33-37) |
| 5. 1987 | ______ | 38 | 62 | (38-42) |

22. **Indicate the years in which a management control evaluation was conducted on the program and/or activity identified earlier. (Check all that apply.)**

| | | | |
|---|---|---|---|
| 1. ☐ None — Go to question 29. | | 23 | (43) |
| 2. ☐ 1987 | CONTINUE | 61 | (44) |
| 3. ☐ 1986 | | 57 | (45) |
| 4. ☐ 1985 | | 50 | (46) |
| 5. ☐ 1984 | | 46 | (47) |
| 6. ☐ 1983 | | 38 | (48) |

23. Who completed the most recent **management control evaluation** of the program and/or activity? (**Check all that apply.**)

| | | |
|---|---|---|
| 1. ☐ Me (or the prior program and/or activity manager) or a member of my (or the prior manager's) staff | 68 | (49) |
| 2. ☐ Agency Inspector General or audit organization personnel | 16 | (50) |
| 3. ☐ Other agency management officials/personnel | 41 | (51) |
| 4. ☐ Consultant/contractor | 2 | (52) |
| 5. ☐ Other (Specify.) ______________________ | 4 | (53) |
| 6. ☐ Unknown | 1 | (54) |

24. How adequate or inadequate is the condition of the **management control systems** in the program and/or activity reflected by the results of the **management control evaluations** conducted? (**Check one.**)

| | |
|---|---|
| 1. ☐ More than adequate — Go to question 26. | 32 |
| 2. ☐ Adequate — Go to question 26. | 62 |
| 3. ☐ Marginally adequate | 5 |
| 4. ☐ Inadequate | 1 |
| 5. ☐ Very inadequate | 0 |

25. If less than "adequate," why? (**Check all that apply.**)

| | |
|---|---|
| 1. ☐ Guidance for performing **management control evaluations** is vague and/or procedures are poorly defined | 47 |
| 2. ☐ Evaluation process is too judgmental and lacks objective valid criteria | 38 |
| 3. ☐ Evaluation based on factors that are not relevant to control over the operation of the function/activity evaluated | 43 |
| 4. ☐ Personnel/organization performing evaluation did not adequately understand the activity/function evaluated | 32 |
| 5. ☐ Other (Specify.) ______________________ | 15 |

______________________
______________________
______________________

26. To what extent, if at all, did the **management control evaluation** identify **management control weaknesses** in the program and/or activity? (**Enter response number in the space provided.**)

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 3 | 3 |
| 2 = To a great extent | 7 | 9 |
| 3 = To a moderate extent | 8 | 13 |
| 4 = To some extent | 12 | 21 |
| 5 = To little or no extent | 35 | 25 |
| 6 = No basis to judge | 6 | 4 |
| N/A / Missing | 29 | 25 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ________ | (81) |
| 2. Nonmaterial Weakness | ________ | [illegible] |

27. To what extent, if at all, were you aware of program and/or activity **management control weaknesses** before a **management control evaluation** was conducted? (**Enter response number in the space provided.**)

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 6 | 6 |
| 2 = To a great extent | 11 | 12 |
| 3 = To a moderate extent | 8 | 16 |
| 4 = To some extent | 12 | 16 |
| 5 = To little or no extent | 10 | 11 |
| 6 = No basis to judge | 6 | 4 |
| 7 = No material/nonmaterial weaknesses exist | 19 | 9 |
| N/A / Missing | 28 | 26 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ________ | [illegible] |
| 2. Nonmaterial Weakness | ________ | [illegible] |

28. To what extent, if at all, have the **management control evaluations** identified **material management control weaknesses** in ADP systems that generate data used by your program and/or activity? (Check one.)

1. ☐ Unknown 16
2. ☐ To a very great extent 2
3. ☐ To a great extent 2
4. ☐ To a moderate extent 6
5. ☐ To some extent 12
6. ☐ To little or no extent 32
7. ☐ Not applicable — data from ADP system not used by program and/or activity 29

Missing 1

29. Does your agency offer internal and/or external training or other direct assistance in conducting **management control evaluations**? (Check one.)

1. ☐ Yes — Continue 69
2. ☐ No — Go to question 35. 31

30. Have you received internal and/or external training in understanding and conducting **management control evaluations**? (Check one.)

1. ☐ Yes — Continue 75
2. ☐ No — Go to question 35. 25

31. What types of training have you had? (Check all that apply.)

1. ☐ Internal classroom 53
2. ☐ External classroom 16
3. ☐ Private consultant 8
4. ☐ On the job training 71
5. ☐ Other (Specify.) ____10____

32. Have you conducted or worked on a **management control evaluation**? (Check one.)

1. ☐ Yes — Continue 87
2. ☐ No — Go to question 35. 14

33. How adequate or inadequate is your agency's training in meeting your needs in conducting **management control evaluations**? (Check one.)

1. ☐ More than adequate 22
2. ☐ Adequate 61
3. ☐ Marginally adequate 15
4. ☐ Inadequate 1
5. ☐ Very inadequate 1

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34. In what areas, if any, does your agency's **management control evaluation** training need major improvement? **(Check all that apply.)**

1. ☐ No major improvements needed (9-10) 52
2. ☐ Defining terms (11-12) 14
3. ☐ Defining the purpose and objectives of the evaluations (13-14) 15
4. ☐ Identifying the procedures required to perform a **management control evaluation** (15-16) 17
5. ☐ Explaining how to analyze and evaluate the results of the **management control evaluation** (17-18) 19
6. ☐ Identifying the documentation needed to support the **management control evaluation** conclusions (19-20) 18
7. ☐ Identifying methodology to be used in evaluating **management controls** of ADP systems (21-22) 16
8. ☐ Identifying methodology to be used in evaluating **management controls** of accounting/financial management systems (23-24) 13
9. ☐ Quality of the presentation and training materials (25-26) 9
10. ☐ Quality of the institutions providing the training (27-28) 2
11. ☐ Other (Specify.) ______________ (29-30) 6

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## V. ACTIONS TO CORRECT MANAGEMENT CONTROL SYSTEMS

**We are interested in collecting program and/or activity manager perceptions of the effectiveness of agency efforts to eliminate management control system weaknesses and the level of agency support for improvement activities.**

35. To what extent, if at all, have actions been implemented to correct **management** control system weaknesses identified, by whatever means, during the past 3 years? **(Enter response number in the space provided.)**

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 14 | 14 |
| 2 = To a great extent | 18 | 23 |
| 3 = To a moderate extent | 11 | 16 |
| 4 = To some extent | 7 | 11 |
| 5 = To little or no extent | 4 | 5 |
| 6 = This type of weakness not identified in the program and/or activity | 24 | 13 |
| 7 = No basis to judge | 17 | 16 |
| Missing | 5 | 4 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ______ | (37) |
| 2. Nonmaterial Weakness | ______ | (38) |

36. To what extent, if at all, have the corrective actions taken eliminated the **management control system weaknesses** identified, by whatever means, during the past 3 years? **(Enter response number in the space provided.)**

| RESPONSE SCALE | MW | NMW |
|---|---|---|
| 1 = To a very great extent | 11 | 13 |
| 2 = To a great extent | 21 | 25 |
| 3 = To a moderate extent | 11 | 15 |
| 4 = To some extent | 7 | 10 |
| 5 = To little or no extent | 4 | 4 |
| 6 = This type of weakness not identified in the program and/or activity | 23 | 12 |
| 7 = No basis to judge | 19 | 18 |
| Missing | 5 | 4 |

| ACTION | RESPONSE NUMBER | |
|---|---|---|
| 1. Material Weakness | ______ | (39) |
| 2. Nonmaterial Weakness | ______ | (40) |

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37. To what extent, if at all, has your agency followed up to determine that planned corrective actions were taken. **(Specify response number.)**

**RESPONSE SCALE**

| | |
|---|---|
| 1 = Not applicable — weaknesses were not identified in the program and/or activity | 13 |
| 2 = To a very great extent | 24 |
| 3 = To a great extent | 22 |
| 4 = To a moderate extent | 12 |
| 5 = To some extent | 8 |
| 6 = To little or no extent | 4 |
| 7 = No basis to judge | 16 |
| Missing | 2 |

| ACTION | RESPONSE NUMBER |
|---|---|
| Corrective Action | ________ |

38. Does your program and/or activity use ADP generated data? (Check one.)

| | |
|---|---|
| 1. ☐ Yes — Continue | 80 |
| 2. ☐ No — Go to question 40 | 12 |
| 3. ☐ Unknown — Go to question 40. | 8 |

39. To what extent, if at all, have the corrective actions taken eliminated the weaknesses in ADP systems that generate data used by the program and/or activity? (Check one.)

| | |
|---|---|
| 1. ☐ Not applicable — ADP system contained no known weaknesses | 39 |
| 2. ☐ To a very great extent | 7 |
| 3. ☐ To a great extent | 14 |
| 4. ☐ To a moderate extent | 10 |
| 5. ☐ To some extent | 9 |
| 6. ☐ To little or no extent | 5 |
| 7. ☐ No basis to judge | 18 |

40. To what extent, if at all, does your agency support actions to correct **management control system weaknesses**? (Check one.)

| | |
|---|---|
| 1. ☐ To a very great extent | 33 |
| 2. ☐ To a great extent | 32 |
| 3. ☐ To a moderate extent | 12 |
| 4. ☐ To some extent | 7 |
| 5. ☐ To little or no extent | 2 |
| 6. ☐ Unknown | 12 |
| Missing | 2 |

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41. How, if at all, has your agency demonstrated its support for correcting **management control system weaknesses** in the program and/or activity? **(Check all that apply.)**

   1. ☐ Not applicable — program and/or activity has no **management control systems** needing corrective action 16
   2. ☐ Agency shows no support for correcting **management** control system weaknesses 2
   3. ☐ Increased funds to make the needed changes 10
   4. ☐ Increased staffing to implement and maintain improved **management** control systems 10
   5. ☐ Memo/letter from agency head discussing the importance of agency efforts to strengthen **management controls** 42
   6. ☐ Direct high-level agency management involvement in determining corrective actions needed 35
   7. ☐ Direct high-level agency management involvement in implementing corrective actions identified 33
   8. ☐ Agency **management** involved in follow-up procedures to determine the timeliness and effectiveness of corrective actions 50
   9. ☐ Required training in **management control system evaluations** and methods to improve weaknesses identified 19
   10. ☐ Other (Specify) ____________ 8

42. What agency actions and/or inactions indicate lack of support for correcting **management control system weaknesses**? **(Check all that apply.)**

   1. ☐ Not applicable — agency actively supports corrections 69
   2. ☐ Verbal support for improvements only 5
   3. ☐ Inadequate increase in funds to make needed changes 9
   4. ☐ Inadequate increase in staff to make needed improvements 14
   5. ☐ Agency priorities higher in improving control systems in other areas or activities within the agency 8
   6. ☐ Agency appears willing to accept the risk of fraud, waste, abuse, or mismanagement that exists under the current **management control systems** 2
   7. ☐ Agency omits important **management control systems** from the evaluation process 1
   8. ☐ Lack of meaningful training 9
   9. ☐ Other (Specify) ____________ 5

43. How adequate or inadequate were the results of the **management control evaluations** of the program and/or activity reflected in your agency's annual report to the President and the Congress (as required by the Federal Manager's Financial Integrity Act)? (**Check one.**)

| | |
|---|---|
| 1. ☐ More than adequate | 11 |
| 2. ☐ Adequate | 31 |
| 3. ☐ Marginally adequate | 2 |
| 4. ☐ Inadequate | 0 |
| 5. ☐ Very inadequate | 0 |
| 6. ☐ No basis to judge — did not see the report | 55 |
| Missing | 1 |

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## VI. COST EFFECTIVENESS OF PROCESS OF EVALUATING AND STRENGTHENING MANAGEMENT CONTROL SYSTEMS

**We are interested in collecting program and/or activity manager perspectives of the costs and benefits resulting from agency efforts to review and evaluate the management control systems within its programs, activities, organizations, and functions.**

44. In your opinion to what extent, if at all, did the improvements that resulted from the work performed to evaluate and strengthen **management control systems** (**risk assessments** and **management control evaluations**) justify the costs to conduct that work? [Please consider all costs incurred (personnel, paperwork, etc.) and your knowledge of the **management control systems** in the program and/or activity.] (**Enter response number in the space provided.**)

RESPONSE SCALE

| | RA | MCE |
|---|---|---|
| 1 = To a very great extent | 5 | 5 |
| 2 = To a great extent | 10 | 12 |
| 3 = To a moderate extent | 21 | 21 |
| 4 = To some extent | 18 | 18 |
| 5 = To little or no extent | 22 | 22 |
| 6 = No basis to judge | 21 | 21 |
| Missing | 2 | 3 |

| ACTION | RESPONSE NUMBER |
|---|---|
| 1. Risk Assessment | ________ |
| 2. Management Control Evaluation | ________ |

45. If less than "to a moderate extent," why? (**Check all that apply in each column.**)

| | Risk Asst. | Mgt. Cont. Eval. | |
|---|---|---|---|
| 1. Work required participation of too many staff | 37 | 41 | (9-10) |
| 2. Length of time (calendar days) excessive | 32 | 34 | (11-12) |
| 3. Work required too much paperwork (documentation and reports) | 59 | 60 | (13-14) |
| 4. Program controls considered adequate before the process | 55 | 55 | (15-16) |
| 5. Process did not identify any weaknesses not already known | 58 | 55 | (17-18) |
| 6. Only insignificant weaknesses identified | 52 | 53 | (19-20) |
| 7. Duplicated assessment or evaluation efforts already conducted by other organizations (i.e., Inspector General, GAO, etc.) | 26 | 24 | (21-22) |
| 8. Other (Specify.) ____________ | 8 | 7 | (23-24) |

|  |  |  |  |  |  |  |  |  |
|---|---|---|---|---|---|---|---|---|
| CD6 |  |  |  |  |  |  | 0 | 6 |

46. What are the most significant benefits, if any, to the program and/or activity as a result of the **risk assessments** and/or **management control evaluations** conducted? (**Check all that apply in each column.**)

|  | Risk Asst. | Mgt. Cont. Eval. |  |
|---|---|---|---|
| 1. No benefit | 20 | 15 | (9-12) |
| 2. Helped better establish priorities within the program and/or activity | 25 | 27 | (13-16) |
| 3. Identified activities/functions which caused inefficient or ineffective operations | 28 | 34 | (17-20) |
| 4. Helped identify actions that could improve the efficiency and effectiveness of the program and/or activity | 39 | 48 | (21-24) |
| 5. Better control over operations | 33 | 37 | (25-28) |
| 6. Better allocation of staff resources | 9 | 13 | (29-32) |
| 7. More accurate and timely information provided by ADP systems | 7 | 10 | (33-36) |
| 8. More accurate and timely information provided by accounting/financial management systems | 7 | 10 | (37-40) |
| 9. Program and/or activity personnel more aware of importance of strong **management control systems** | 41 | 50 | (41-44) |
| 10. Identified material problems for top management consideration | 14 | 17 | (45-48) |
| 11. Program and/or activity personnel actively attempt to identify and improve **management control system weaknesses** | 21 | 28 | (49-52) |
| 12. Improved efficiency/effectiveness in accomplishing the program and/or activity's mission | 22 | 31 | (53-56) |
| 13. Focused attention on solving long-standing problems | 19 | 24 | (57-60) |
| 14. More effective or better controlled ADP or accounting/financial management systems were developed and implemented | 7 | 9 | (61-64) |
| 15. Other (Specify.) ________ | 6 | 6 | (65-68) |

CD7 ☐☐☐☐☐☐ 0 7

47. What, if any, are the most significant problems occurring in the program and/or activity as a result of the implementation of the Integrity Act? **(Check all that apply in each column.)**

| | Risk Asst. | Mgt. Cont. Eval. | |
|---|---|---|---|
| 1. No significant problems observed | 63 | 61 | (69-70) |
| 2. Program slippage | 3 | 3 | (71-72) |
| 3. New **management control systems** priorities inconsistent with meeting program objectives | 6 | 5 | (73-74) |
| 4. Control procedures too time consuming/burdensome | 23 | 24 | (75-76) |
| 5. Budget cuts hinder implementation of control improvements | 16 | 19 | (77-78) |
| 6. Other (Specify.) ______________ | 8 | 8 | (79-80) |

______________
______________
______________

48. To what extent, if at all, does the process used in your agency to conduct reviews of **management control systems** assess the adequacy of the controls in effect in your program and/or activity?
**(Check one.)**

| | |
|---|---|
| 1. ☐ To a very great extent | 12 |
| 2. ☐ To a great extent | 31 |
| 3. ☐ To a moderate extent | 24 |
| 4. ☐ To some extent | 13 |
| 5. ☐ To little or no extent | 4 |
| 6. ☐ No basis to judge | 14 |
| Missing | 2 |

49. To what extent, if at all, have **management controls** in your program and/or activity improved as a result of the Integrity Act? **(Check one.)**

| | |
|---|---|
| 1. ☐ To a very great extent | 2 |
| 2. ☐ To a great extent | 12 |
| 3. ☐ To a moderate extent | 21 |
| 4. ☐ To some extent | 21 |
| 5. ☐ To little or no extent | 15 |
| 6. ☐ No basis to judge | 26 |
| Missing | 3 |

50. What is your overall opinion of the **Federal Managers' Financial Integrity Act** program in your Agency/Department? (**Check one.**) ([illegible])

| | |
|---|---|
| 1. ☐ Very successful | 4 |
| 2. ☐ Successful | 35 |
| 3. ☐ Marginally successful | 23 |
| 4. ☐ Unsuccessful | 3 |
| 5. ☐ Very unsuccessful | 1 |
| 6. ☐ No basis to judge | 33 |
| Missing | 1 |

GO TO NEXT PAGE

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| CD8 | | | | | | 0 | 8 |

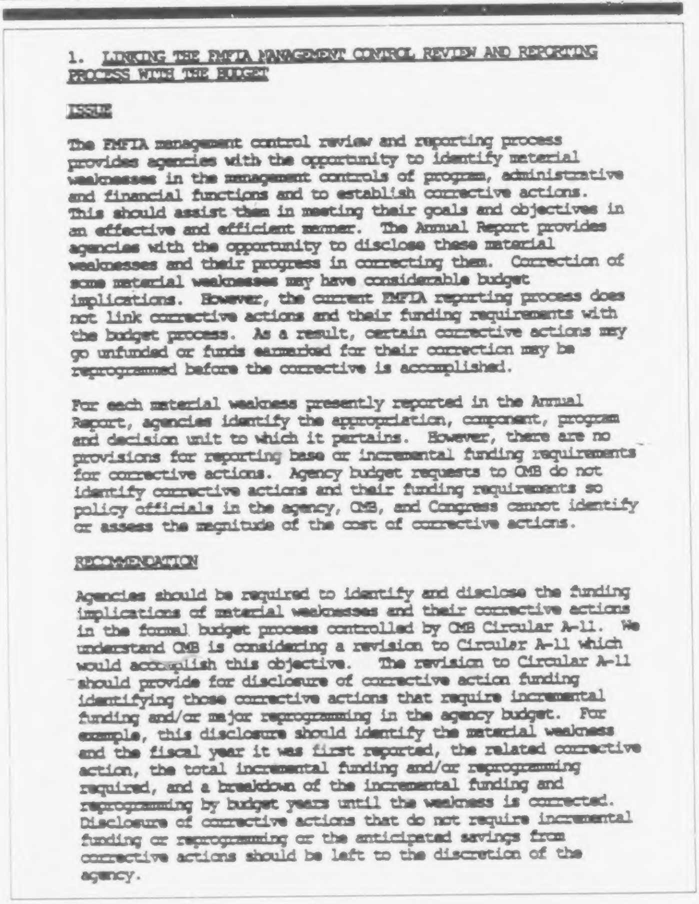
## VII. ADDITIONAL COMMENTS

51. If you have any additional comments on any of the items in this questionnaire or related topics, please express your views in the space below (**Attach additional sheets, if necessary.**) **Thank you for your cooperation.** [illegible]

| | |
|---|---|
| No Comments | 78 |
| Comments | 22 |

(WMC, PEMD, May 1988)

# Excerpts of Issues and Recommendations From the Internal Control Interagency Coordination Council Report



1. LINKING THE FMFIA MANAGEMENT CONTROL REVIEW AND REPORTING PROCESS WITH THE BUDGET

ISSUE

The FMFIA management control review and reporting process provides agencies with the opportunity to identify material weaknesses in the management controls of program, administrative and financial functions and to establish corrective actions. This should assist them in meeting their goals and objectives in an effective and efficient manner. The Annual Report provides agencies with the opportunity to disclose these material weaknesses and their progress in correcting them. Correction of some material weaknesses may have considerable budget implications. However, the current FMFIA reporting process does not link corrective actions and their funding requirements with the budget process. As a result, certain corrective actions may go unfunded or funds earmarked for their correction may be reprogrammed before the corrective is accomplished.

For each material weakness presently reported in the Annual Report, agencies identify the appropriation, component, program and decision unit to which it pertains. However, there are no provisions for reporting base or incremental funding requirements for corrective actions. Agency budget requests to OMB do not identify corrective actions and their funding requirements so policy officials in the agency, OMB, and Congress cannot identify or assess the magnitude of the cost of corrective actions.

RECOMMENDATION

Agencies should be required to identify and disclose the funding implications of material weaknesses and their corrective actions in the formal budget process controlled by OMB Circular A-11. We understand OMB is considering a revision to Circular A-11 which would accomplish this objective. The revision to Circular A-11 should provide for disclosure of corrective action funding identifying those corrective actions that require incremental funding and/or major reprogramming in the agency budget. For example, this disclosure should identify the material weakness and the fiscal year it was first reported, the related corrective action, the total incremental funding and/or reprogramming required, and a breakdown of the incremental funding and reprogramming by budget years until the weakness is corrected. Disclosure of corrective actions that do not require incremental funding or reprogramming or the anticipated savings from corrective actions should be left to the discretion of the agency.

ANTICIPATED BENEFITS

Disclosing corrective action funding requirements in annual budget requests should assist the President and Congressional decision-makers in analyzing the impact of corrective actions on agency resources. In linking the FMFIA management control process with the budget process, agencies must recognize the timing difference in submitting the annual agency budget request to OMB, conducting the management control review process, and issuing the Annual Report, in addition to the difference in fiscal years between the annual budget request and Annual Report.

## 2. EMPHASIZING EARLY WARNING CAPABILITIES

### ISSUE

The Administration has emphasized that more effective use should be made of existing management processes and mechanisms that anticipate, identify and resolve mission critical issues. The management control review and reporting process is one of the more important "early warning" systems available to agency management to identify and gauge potential mission critical issues. The review and reporting processes are separate processes. The review process is a continuing assessment during the year while the reporting process is tied to the Annual Report. For early warning purposes, whenever a review identifies a weakness that warrants the attention of senior management, internal management processes should provide for immediate notification instead of waiting for the normal reporting of the weakness in the Annual Reporting process. This early warning capability has not been encompassed or effectively utilized by senior agency management on a governmentwide basis.

### RECOMMENDATION

Agency management directives on the management control review and reporting process and FMFIA implementing guidance should emphasize the inherent early warning capabilities of this process. Agency management should effectively incorporate the results of the management control review and reporting process into the agency decision-making process, if they have not already done so,--in order to ensure that mission critical issues are identified and elevated to senior agency management in a timely manner.

Agency management control review and reporting processes and FMFIA related training curriculums should emphasize the early warning capability and the actual and potential uses of the results of management control assessments and evaluations.

### ANTICIPATED BENEFITS

This will greatly improve the overall effectiveness of the FMFIA program by ensuring that the results of the management control review and reporting process are effectively utilized. It will enhance agency management's understanding of the purpose and usefulness of the management control review and reporting process and increase senior management awareness of, and attention to, management control weaknesses (material and otherwise) discovered.

## 3. CONSOLIDATING REVIEW PROCESSES OF OMB CIRCULARS

### ISSUE

Most agencies do not employ a consolidated review approach to fulfill the review requirements of OMB A-123, A-127 and A-130. There are several instances where the subject matter and methodologies used for these reviews are virtually identical. Adopting a consolidated review approach could eliminate duplicative and overlapping procedures, reduce the paper-flow associated with agency review guidance and documentation, and provide for more effective utilization of agency review resources. The Department of Agriculture has piloted and implemented a consolidated review program which has resulted in more cost-effective, less paper intensive, and more meaningful reviews processes under OMB A-123, A-127 and A-130.

### RECOMMENDATION

Agencies should be referred to the consolidated review pilot program at the Department of Agriculture to determine if they want to implement a similar process. If so, agencies should be encouraged to develop or adopt appropriate implementing guidelines. This recommendation only pertains to the consolidation of review processes and not agency organizational components responsible for the review processes. In the next revision to these circulars, OMB should eliminate overlapping and repetitive review requirements and encourage agencies to adopt a consolidated review approach.

### ANTICIPATED BENEFITS

Adopting a consolidated review approach for these circulars should result in a more streamlined review process. It should eliminate overlapping review requirements and provide for improved utilization of personnel involved in the review processes. It should facilitate the targeting of limited resources and improve the overall quality and utility of the reviews. It should also result in a less "paper intensive" review process by enabling agencies to consolidate annual review guidance and documentation.

## 4. ENHANCING SENIOR MANAGEMENT INVOLVEMENT

### ISSUE

In recent testimony before Congress and pronouncements from OMB, it has been stated that the participation of senior-level management officials in the FMFIA management control review and reporting process is essential. It is extremely difficult to implement management control programs in those instances where senior-level management support is lacking, or is perceived to be lacking.

It is often difficult to get senior-level management involved in the FMFIA management control review and reporting process on a regular basis. Some agencies have resolved this dilemma by establishing policy committees composed of senior ranking officials within the agency to review and provide oversight on the management control process and the preparation of the Annual Report. Other agencies have resolved this dilemma through more informal management processes. The policy committee concept has proven to be successful in stimulating senior-level management participation and has been widely credited for improving the scope and quality of agency FMFIA management control review and reporting processes and related FMFIA activities.

### RECOMMENDATION

Agencies not currently having senior-level management involvement in the FMFIA management control review and reporting process should be encouraged to establish senior-level policy committees to provide oversight on this process and related FMFIA activities. In addition, the PCMI, CFOC, and PCIE should actively promote senior-level management participation in this process.

### ANTICIPATED BENEFITS

The establishment of senior-level management policy committees is consistent with the goal of providing for more effective administration of the FMFIA management control review and reporting process. It should provide for more consistent and lasting oversight and accountability in this process and related FMFIA activities. It should also enhance senior-level management awareness of the interrelationship of and support provided by this process to essential management functions like long-range planning, accounting and budget formulation.

## 5. HIGHLIGHTING CRITICAL WEAKNESSES

### ISSUE

The Administration has expressed a desire to better utilize existing management processes and reporting mechanisms to improve strategic planning and better anticipate mission critical issues and problems. The Annual Report has the potential to function in this capacity, but the reporting requirements are not structured to specifically identify the most critical weaknesses or areas of weakness detected in the FMFIA management control review and reporting process. Presently, all material weaknesses are listed individually in Section 2 of the Annual Report without regard to their significance or priority. Weaknesses that may be most critical and warrant the special consideration of OMB, the President and Congress are not identified in this manner in the Annual Report. They remain buried along with other material weaknesses in Section 2.

### RECOMMENDATION

Agencies should be required to specifically identify to OMB, the President and Congress the most critical internal control weaknesses or areas of weakness affecting their missions. Agencies should highlight those weaknesses which, in the opinion of agency management, warrants the special attention of the President and Congress. The agency head should have discretion in determining how to best accomplish this objective. Three options are (1) highlighting the most critical weaknesses in the annual FMFIA assurance letter, (2) prioritizing the material weaknesses listed in Section 2 of the Annual Report, and (3) banding the most critical weaknesses in the Annual Report.

### ANTICIPATED BENEFITS

Highlighting or prioritizing the most critical weaknesses in the assurance letter or Annual Report should improve the overall effectiveness of the FMFIA reporting process with little, if any, additional reporting burden on agencies. It should provide senior-level management with flexibility in the identification and reporting the most critical weaknesses affecting their missions. It should also emphasize to cognizant agency managers which issues are of primary concern to senior-level management and identify the need for special funding requirements for corrective actions.

## 6. VALIDATING CORRECTIVE ACTIONS

### ISSUE

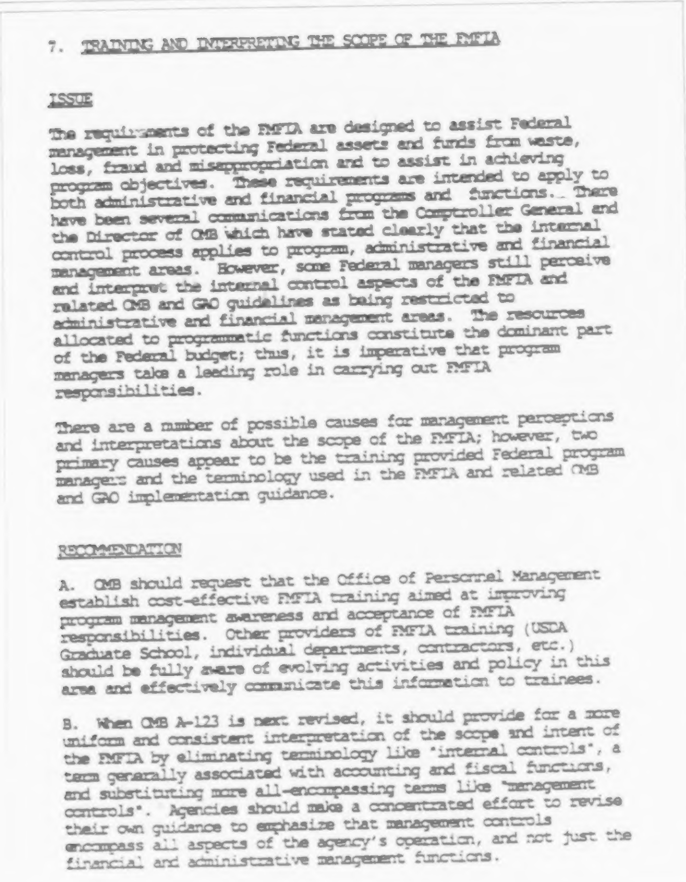
The Administration has indicated that it is focusing on the "results" to be obtained from programs and management processes. It is essential that management controls be in place, appropriate, and functioning as intended. Therefore, the results an agency expects [illegible] corrective actions it proposes should be clearly defined. [illegible]nvolves going beyond the reporting of milestones for com[illegible] actions to a clear and definitive statement of expected results. Once corrective actions are completed, they should be reviewed to ascertain that the desired results were achieved. The Annual Report does not address the validation by management that corrective actions were taken as reported and were effective.

### RECOMMENDATION

Agencies should be encouraged to include a narrative statement in the Annual Report explaining what processes were used to assure themselves that completed corrective actions were effective. Agencies should maintain appropriate documentation that indicates that corrective actions have been accomplished and were effective. The participation of the agency Inspector General in validating that corrective actions have been taken and were effective should also be strongly encouraged.

### ANTICIPATED BENEFITS

Validating corrective actions in the Annual Report will not significantly increase the FMFIA reporting burden of agencies. It should increase agency awareness of the importance of having systems in place to validate corrective actions, thereby reducing the likelihood of repeated occurrences of the same weakness. It should also establish a system that can be reviewed by audit organizations both within and outside the agency.



7. TRAINING AND INTERPRETING THE SCOPE OF THE FMFIA

ISSUE

The requirements of the FMFIA are designed to assist Federal management in protecting Federal assets and funds from waste, loss, fraud and misappropriation and to assist in achieving program objectives. These requirements are intended to apply to both administrative and financial programs and functions. There have been several communications from the Comptroller General and the Director of OMB which have stated clearly that the internal control process applies to program, administrative and financial management areas. However, some Federal managers still perceive and interpret the internal control aspects of the FMFIA and related OMB and GAO guidelines as being restricted to administrative and financial management areas. The resources allocated to programmatic functions constitute the dominant part of the Federal budget; thus, it is imperative that program managers take a leading role in carrying out FMFIA responsibilities.

There are a number of possible causes for management perceptions and interpretations about the scope of the FMFIA; however, two primary causes appear to be the training provided Federal program managers and the terminology used in the FMFIA and related OMB and GAO implementation guidance.

RECOMMENDATION

A. OMB should request that the Office of Personnel Management establish cost-effective FMFIA training aimed at improving program management awareness and acceptance of FMFIA responsibilities. Other providers of FMFIA training (USDA Graduate School, individual departments, contractors, etc.) should be fully aware of evolving activities and policy in this area and effectively communicate this information to trainees.

B. When OMB A-123 is next revised, it should provide for a more uniform and consistent interpretation of the scope and intent of the FMFIA by eliminating terminology like "internal controls", a term generally associated with accounting and fiscal functions, and substituting more all-encompassing terms like "management controls". Agencies should make a concentrated effort to revise their own guidance to emphasize that management controls encompass all aspects of the agency's operation, and not just the financial and administrative management functions.

ANTICIPATED BENEFITS

This should provide for more consistent interpretation and acceptance of FMFIA responsibilities on the part of Federal program managers. It should also provide a more cost-effective and efficient means of providing comprehensive FMFIA training.

Appendix VI

# Major Contributors to This Report

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